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IN THE

Supreme Court of the United States

OCTOBER TERM, 1962

No. 584

THE MORRIS PLAN COMPANY OF CALIFORNIA,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

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Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

To the Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

Petitioner, The Morris Plan Company of California, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit, entered May 22, 1962, reversing a decision of the Tax Court of the United States, entered June 14, 1960.

Opinions Below.

The United States Court of Appeals for the Ninth Circuit wrote an opinion in this case[1] which is published

[1]Petitioner's case was consolidated for argument, on review in the Court of Appeals, with another presenting a similar issue and having similarly resulted in a Tax Court determination adverse to the Government. *Valley Morris Plan*, 33 T.C. 572. The decision of the Court of Appeals was ultimately entered under the style of *Commissioner of Internal Revenue v. Valley Morris Plan.*

at ..... F.2d ....., 1962-1 U.S.T.C. par. 9495, 9 A.F.T.R. 2d 1561. Such opinion is annexed as Appendix A to this Petition. The Tax Court of the United States wrote an opinion in this case which is published at 33 T.C. 720. Such opinion forms Appendix B of this Petition. The Court of Appeals for the Ninth Circuit accompanied its denial of petitioner's petition for rehearing, which denial was entered on June 29, 1962, with an opinion which has not yet been published. Such opinion accompanying denial for rehearing is annexed as Appendix C to this petition.

Grounds of Jurisdiction.

The judgment of the United States Court of Appeals for the Ninth Circuit was entered on May 22, 1962. A petition for rehearing pursuant to Rule 23 of the rules of that court was timely filed; such petition was denied and the order of denial was entered on June 29, 1962. On September 15, 1962, by order of Mr. Justice Black, the time within which to file the petition for a writ of certiorari was extended to and including November 26, 1962. This Court has jurisdiction to issue a writ of certiorari to the Court of Appeals for the Ninth Circuit in this case under the provisions of Section 1254(1), Title 28 of the United States Code.

Questions Presented.

(1) Is petitioner, an industrial loan company, organized under the provisions of CALIF. FIN. CODE §§ 18000-18825, entitled to include the amount of its is-

sued and outstanding "Thrift Certificates" in the computation of its "average borrowed capital" and ultimately of its "invested capital credit," thus reducing its tax base for application of the Korean War Excess Profits Tax?

(2) Has the Court of Appeals for the Ninth Circuit so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision under the following circumstances:

(a) The decision of the Court of Appeals results in a reversal of a decision of an expert administrative body, the Tax Court of the United States, and of a doctrine and policy authoritatively settled by that administrative body;

(b) The decision of the Court of Appeals creates a direct and irreconcilable conflict with the decision of the Court of Appeals for the Tenth Circuit in *Jackson Finance & Thrift Co. v. Commissioner of Internal Revenue* (10th Cir. 1958), 260 F. 2d 578, and with that of the Court of Appeals for the Sixth Circuit in *United States v. City Loan & Savings Co.* (6th Cir. 1961), 287 F. 2d 612;

(c) The decision of the Court of Appeals involves confirming a retroactive change of opinion by the Commissioner of Internal Revenue, which change of opinion was made in the face of a fourteen-year old administrative acquiescence;

(d) The decision of the Court of Appeals involves the retroactive imposition of a tax predicated on a course of action taken by petitioner prior to the Commissioner's arbitrary change of opinion;

(e) The decision of the Court of Appeals is grounded on statutory language which, in the Court's opinion accompanying its denial of rehearing, was admitted not to bear the interpretation earlier put on it;

(f) The question decided involves the application of a statutory provision critical in the administration of the Excess Profits Income Tax Act?

(3) Are leasehold improvements "facilities" within the meaning of the Internal Revenue Code of 1939, §444(d), as added by Excess Profits Tax Act of 1950, §§ 101, c. 1199, 64 Stat. 1137, 1168?[2]

Statutes and Regulations.

This case involves the following statutes and regulations:

Internal Revenue Code of 1939, §§ 436, 437, 439, 444, as added by § 101, Excess Profits Tax Act of 1950, c. 1199, 64 Stat. 1137;

Treasury Regulations 130, § 40.439-1.

These statutes and regulations are set forth in full in Appendix D annexed to this petition.

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[2]Petitioner recognizes that this question would not, in other circumstances, be very likely to result in exercise by this Court of its jurisdiction. Petitioner believes, however, that it is entitled —under the rule of law—to have *one* judicial consideration of this question. In the opinion of the Court of Appeals, it is erroneously stated that the Tax Court passed on this question; it did not. Although this error was brought to the attention of the Court of Appeals, no change was made in its opinion. For this reason, petitioner believes itself now entitled to present this question.

Statement of the Case.

Petitioner is a California corporation which is engaged in that state in the business of discounting consumer paper and making small loans. The taxable years involved are 1950, 1951 and 1952, and petitioner is contesting deficiencies for Excess Profits Tax in those years aggregating more than $265,000.[3]

Petitioner is regulated under the provisions of California's "Industrial Loan Law."[4] Under that law, an industrial loan company must have a substantial minimum capital. For that reason and for business reasons, industrial loan companies obtain some of their capital by the issuance and sale of their common stock; some California industrial loan companies obtain the remainder of their working capital solely through bank borrowings. Petitioner obtained working capital both from the sale of its common stock and from loans through banks, but primarily it obtained that capital from the issuance and sale of its Thrift Certificates[5] to the public generally.

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[3]The specific amounts of additional tax proposed to be assessed in this case together with amounts which the Commissioner refused to include in "average borrowed capital" are as follows:

Year	Average daily balance of outstanding "Thrift Certificates" (excluded by Commissioner from "borrowed capital")	Proposed deficiency in Excess Profits Tax
1950	$16,073,897	$ 26,218
1951	17,866,997	93,077
1952	23,962,294	147,416

[4]CAL. FIN. CODE §§ 18000-18825.

[5]CAL. FIN. CODE § 18402 "An industrial loan company may . . . sell or negotiate investment certificates. . . ." CAL. FIN. CODE § 18403 "Nothing in this division authorizes an in-

These Thrift Certificates are not distributed like corporate or municipal bonds and are not traded on an exchange. They are sold through petitioner's offices in the first instance and are assignable generally as are other corporate securities. These securities are extremely flexible, both from petitioner's point of view and from the point of view of the investor. Generally, they are redeemable at the demand of the investor; legally, that demand is subject to limitations protecting petitioner's liquid position, but as a practical matter such limitations have never been enforced by petitioner. During the taxable years in question, Thrift Certificates of various types were issued by petitioner, such as Unit Thrift Certificates, Definite Term Thrift Certificates, and Installment Thrift Certificates. The last is by far the most flexible of these securities.[6] It also is the type most widely distributed by petitioner in the years in question. Despite the variations among these types, the Court of Appeals considered all of petitioner's Certificates as having identical excess profits tax consequences.

Thrift Certificates of all types were issued only under a permit of the California Corporations Commissioner applied for and granted in a manner identical with, and under standards similar to, those employed by that administrative official in respect to any other senior corporate securities (the Securities & Exchange Commission similarly treated the Certificates as securities). Applications for such a permit had to be sup-

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dustrial loan company to receive deposits or issue certificates of deposit."

[6]The Tax Court found: "The owner could add to his Unit Thrift Certificate $100 or multiples thereof. The owner could add to his Installment Thrift Certificate $1 or multiples thereof."

ported by current financial information, by a certified resolution of the Directors pertaining to the issue, by a copy of the proposed form of certificate, and by information as to the existing capital structure of the company and as to the total amount of the proposed new issue, the interest rate to be paid thereon and the period during which the issue would be brought out.

Petitioner sold certificates, after receiving authorization to do so, to the public through advertisements in financial journals and through other media of advertisement, but all such advertisement was subject to the approval of the Commissioner of Corporations who is particularly concerned to prevent any possible confusion in the public mind between petitioner's certificates and bank deposits.

On the advice of its accountants, petitioner computed its "excess profits credit" during the years involved by the "invested capital" method.[7] Under the Excess Profits Tax Act of 1950, generally speaking, an additional tax was imposed on every corporation's "excess profits income." The theory of this tax—enacted under the pressure of adverse events in the spring of 1950 and paralleling a similar tax in force during the World War II—is that it is a tax to be imposed only on *extraordinary income attributable to an abnormal national situation.* In practice, the tax is imposed on all "excess profits net income" in excess of the amount of the taxpayer's "excess profits credit," each of those figures

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[7]Under the Excess Profits Tax Act of 1950, a taxpayer is free to claim the larger credit—that computed by the "invested capital" method or that computed by the "income" method. The latter method is involved in the alternative issue presented to this Court as question (3).

being the result of an artificial and arbitrary computation.

Under the "invested capital" method of computing its credit, the taxpayer is entitled to reduce its excess profits income by an amount representing the statutory rate of return (varying from 8 to 12 per cent) on its invested capital. Section 437(b)[8] defines "invested capital" as including "equity capital" and three-fourths of "borrowed capital."

"Borrowed capital" is defined, so far as is here relevant, as:

> "The amount of the outstanding indebtedness (not including interest) of the taxpayer, incurred in good faith for the purposes of the business, which is evidenced by a bond, note, bill of exchange, debenture, *certificate of indebtedness*, mortgage, deed of trust, bank loan agreement, or conditional sales contract."[9]

Computing its excess profits credit, as stated, by the invested capital method, petitioner included in that computation a figure representing the allowed percentage of the amount of outstanding Thrift Certificates as a portion of its "borrowed capital." Although agents of the Internal Revenue Service auditing petitioner's returns from year to year made no objection to such in-

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[8]Unless otherwise indicated, a statutory citation refers to the Internal Revenue Code of 1939 as applicable during the taxable years involved in this case.

[9]Section 439(b)(1) (Emphasis added.) See Appendix D, infra, for the substantially identical language of § 719(a)(1) of the World War II Act. Int. Rev. Code of 1939, § 719(a)(1), added by Second Revenue Act of 1940, § 201, c. 757, 54 Stat. 974, 984, and repealed by Revenue Act of 1945, § 122(a), c. 453, 59 Stat. 556, 568.

clusion, the Commissioner changed his original position on this question in the spring of 1953 and concluded that amounts received for investment certificates of this nature were not includable in borrowed capital. His change of position in this regard, however, was not communicated to petitioner until January, 1954 on an administrative post-audit.[10]

The Commissioner for the first time then took the position that investment certificates of the sort here involved are not "certificate[s] of indebtedness" as that term is used in § 439(b)(1). In his Regulations, both those implementing the 1950 Act[11] and those implementing the World War II Act,[12] the Commissioner dis-

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[10]The leading case on this point was *Economy Savings & Loan Co.* (1945), 5 T.C. 543, *mod. on other grounds*, 158 F.2d 472 (6th Cir.), involving the predecessor provision of the World War II Excess Profits Tax Act. Economy Savings & Loan Company was an Ohio association engaged in the business of making chattel loans; it issued certificates of deposit for money left with it for periods of six months or longer. The Tax Court held that amounts represented by these certificates were includable in borrowed capital. The Commissioner acquiesced (1945 CUM. BULL. 3) and did not withdraw his acquiescence until 1959, 1959-1 CUM. BULL. 6-7, long after the instant deficiencies had been found as to petitioner.

[11]"The term 'certificate of indebtedness' includes only instruments having the general character of investment securities issued by a corporation as distinguishable from instruments evidencing debts arising in ordinary transactions between individuals. . . . Borrowed capital does not include indebtedness incurred by a bank arising out of the receipt of a deposit and evidenced, for example, by a certificate of deposit, a passbook, a cashier's check, or a certified check, and the term 'bank loan agreement' does not include the indebtedness of a bank to a depositor."

[12]"The term 'certificate of indebtedness' includes only instruments having the general character of investment securities issued by a corporation as distinguishable from instruments evidencing debts arising in ordinary transactions between individuals. Borrowed capital does not include indebtedness incurred by a bank arising out of the receipt of a deposit and evidenced, for example, by a certificate of deposit, a passbook, a cashier's check, or a certified check."

tinguished not only between "certificate[s] of indebtedness" which have "the general character of investment securities" and evidences of debts arising in ordinary transactions, but also between such "investment securities" and evidences of the "indebtedness incurred by a bank arising out of a receipt of a deposit." Contending (under his new view of the matter) that petitioner's Thrift Certificates were evidences of a "deposit," the Commissioner wholly excluded proceeds of the issuance of such Certificates from petitioner's computation of its borrowed capital.

On notification of the deficiency, petitioner sought a redetermination in the Tax Court (invoking Section 6213(a)). After a full hearing on this issue, petitioner was entirely successful. In a decision reviewed by the full Court, Judge Murdock wrote an opinion holding that the Thrift Certificates were includable in borrowed capital. The Government petitioned for review, and a panel of the Court of Appeals for the Ninth Circuit reached a conclusion opposite to that of the Tax Court and ordered a reversal of its decision.

The Tax Court considered the similarity of the Thrift Certificates involved in this case to "instruments having the general character of investment securities issued by a corporation," on the one hand, and to "indebtedness incurred by a bank arising out of a receipt of a deposit," on the other hand. It found that petitioner paid interest at a rate of 2% to 4% on its Installment Thrift Certificates (and from 1½% to 3% on other types of certificates), while the prevailing interest rates paid on bank savings accounts never exceeded 1% to 2% during the same period. The Tax Court further found that

petitioner's Installment Thrift Certificates (which are the most flexible of petitioner's securities) differed even from bank savings accounts which were represented by a passbook at least as follows:

(1) These certificates have all the formal attributes of corporate senior securities in that they are signed by the issuer, registered and, on assignment, are transferred by endorsement. The certificates could either be endorsed at petitioner's office or the assignment could be completed by forwarding a properly endorsed certificate for assignment with the signature guaranteed, as in the case of the assignment of a stock certificate.

(2) Certificates are transferrable and can be used as collateral.

(3) The right of a certificate owner to make a withdrawal is limited, although during the taxable years involved petitioner did not invoke those limitations.

(4) Despite the failure of petitioner to invoke the contractual limitations on withdrawal, purchasers of certificates were significantly less assured of liquidity than were depositors in a bank since petitioner was not required to maintain reserves of the kind a bank would be required to maintain.

In connection with these findings, the Tax Court further held that petitioner was subject to regulation different from that to which a bank is subject and to regulation administered by a state authority (California Corporations Commissioner) who does not have supervi-

sion over banking institutions and that petitioner is subject to no authority having such supervision.[13]

Based on these findings, a unanimous Tax Court concluded:

> "It seems fair to conclude from the entire record that [the purchases of Thrift Certificates] represented investments by the holders of the Certificates. They were similar in many respects to the types of evidences of indebtedness listed in section 439(b)(1). . . .
>
> "This Court, after restudying the whole question, has come to the conclusion that all of the indebtedness evidenced by the Certificates issued by the present petitioner should be included in the computation of the invested capital credit under section 439(b)(1)."
>
> 33 T.C. 720.

* * * * *

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[13]The Government's turn-about attack on inclusion in borrowed capital of amounts received for Thrift Certificates is, to a large extent, based on its contention—the materiality of which may be questioned—that petitioner is a "bank" within the meaning of Section 104(a) of the Internal Revenue Code:

> "As used in this section the term 'bank' means a bank or trust company incorporated and doing business under the laws of the United States (including laws relating to the District of Columbia), of any State, or of any Territory, a substantial part of the business of which consists of receiving deposits and making loans and discounts, or of exercising fiduciary powers similar to those permitted to national banks under section 11(k) of the Federal Reserve Act, 38 Stat. 262 (U.S.C., Title 12, § 284k), as amended, and which is subject by law to supervision and examination by State, Territorial or Federal authority having supervision over banking institutions. Such term also means a domestic building and loan association."
>
> Int. Rev. Code of 1939, § 104(a), as amended by § 313(h) Revenue Act of 1951, c. 521, 65 Stat. 452.

The facts necessary for an understanding of petitioner's third question can be set out as follows: Under § 444, special relief was available to a corporation which, roughly speaking, had long been in business and had substantially increased its "capacity for production or operation" between 1947 and 1950. Relief consisted of allowing qualified taxpayers to compute a substituted average base period net income (for excess profits credit purposes) which was arrived at by multiplying total assets held on the last day of the taxpayers' last pre-excess-profits-tax year by a base period rate of return especially proclaimed by the Secretary of the Treasury. Increase in "capacity for production or operation" is the key to qualifying for relief under this section. Such an increase exists where the unadjusted basis of the taxpayer's "facilities" doubled between the beginning and the end of the test period. "Facilities" are defined in the section as "real property and depreciable tangible property." If improvements to leaseholds are included in petitioner's "facilities," then petitioner fails to show the requisite doubling of unadjusted basis. If leasehold improvements are excluded from facilities, the doubling exists and petitioner qualifies for relief.

Since such qualification presented an alternative issue in the courts below to the "borrowed capital" issue, petitioner's contentions as to this issue were not reached by the Tax Court. On review, the Court of Appeals, misreading the opinion of the Tax Court, erroneously asserted that that body had decided the issue against petitioner.[14] It then proceeded to affirm what is mistakenly thought to be the conclusion of the Tax Court.

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[14]The Tax Court said: "The alternative issue raised by the petitioner need not be considered or decided in view of this holding."

Petitioner's arguments on this issue were, briefly, that leasehold improvements (having a useful life greater than the term of the leases) are "amortizable" and not "depreciable" and that, further, the limited possessory interest of a lessee in leasehold improvements subject to reversion (even though those improvements themselves are of a tangible nature) is intangible in nature. These arguments, it can easily be seen, raise delicate questions as to the Congressional meaning in defining "facilities." Petitioner's simple contention in this Court is that it is entitled, at least, to a resolution of these arguments in the Tax Court in the first instance. By the Court of Appeals' oversight, which stands uncorrected, petitioner has been denied this primary hearing. Accordingly, petitioner does not press for a decision on this issue, but, in the absence of a decision by this Court on the "borrowed capital" issue favorable to petitioner, requests that this Court vacate the existing judgment of the Court of Appeals, and remand to that Court with directions that it remand to the Tax Court for a full hearing and decision on this issue.

Reasons for Granting the Writ.

There Exists a Conflict Between the Ninth and the Tenth and Sixth Circuits.

1. The basic substantive question presented herein requires the proper construction of a statute and its implementing regulation, a part of the Excess Profits Tax Act of 1950.

The decision of the Court of Appeals for the Ninth Circuit in this case expressly repudiates the decision of the Court of Appeals for the Tenth Circuit in *Jack-*

son Finance & Thrift Company v. Commissioner of Internal Revenue, 260 F.2d 578. The decision of the Ninth Circuit is also directly in conflict with the decision of the Court of Appeals for the Sixth Circuit in *United States v. City Loan & Savings Company*, 287 F.2d 612.

The critical question in all three cases was whether money obtained by the taxpayer through the issuance and sale of certain instruments constituted "borrowed capital" so as to qualify for inclusion in the taxpayer's "invested capital" for Excess Profits Tax purposes. That question, in turn, has been refined down to a question posed by the Government's implementing regulations: were the issuance and sale of these Thrift Certificates transactions having "the general character of investment securities" or transactions having the character of "indebtedness incurred by a bank arising out of the receipt of a deposit." *Petitioner does not find, and has never found, it necessary to disagree with the exclusion of bank deposits from borrowed capital.*[15] The question has rather been as to whether Thrift Certificates issued by petitioner fall into one category or the other of those set up by the regulations.

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[15]The exclusion is apparently based on the historical distinction between bank deposits and ordinary loans. See *Commissioner of Internal Revenue v. Ames Trust & Savings Bank* (8th Cir. 1950), 185 F.2d 47. The Tax Court has followed the *Ames* decision because it concluded with the Sixth Circuit that "bank deposits do not have the character of investment securities." For the distinction between "deposits" and "loans," the Tax Court quoted from 5 ZOLLMAN, BANKS & BANKING, § 3154:

> "The main purpose of a loan is investment. The main purpose of a deposit is safe-keeping. A deposit clearly is not a loan pure and simple. The depositor deals with the bank not merely on the basis that it is a borrower, but that it is a bank subject to the provisions of law relating to the custody and disposition of the money deposited and that the bank will faithfully observe such provisions."

Until 1953, the Government did not attack the includability of such Thrift Certificates, the matter being governed by its acquiescence in *Economy Savings & Loan Co., supra.*. It had, however, prevented the extension of the *Economy* doctrine to time savings accounts of institutions which were admittedly and literally banks in the fullest sense of the word.[16]

When the Commissioner of Internal Revenue changed his mind as to Thrift Certificates such as petitioner's, his attack on the question had two prongs:

> (1) He argued, from the similarity of industrial loan companies to banks (since both perform financial functions considered in a broad sense), that such industrial loan companies were in fact "banks" as that term is used in his regulation, § 40.439-1(f).[17]

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[16]*Commissioner of Internal Revenue v. Ames Trust & Savings Bank* (8th Cir. 1950), 185 F.2d 47, reversing 12-T.C. 770; *National Bank of Commerce* (1951), 16 T.C. 769; *Capital National Bank of Sacramento* (1951), 16 T.C. 1202; *LaSalle National Bank* (1954), 23 T.C. 479; *Southern Bank of Norfolk* (1952), 11 T.C.M. 47. It was always patent that includability of a bank's time savings account was distinct and separate from that involved in *Economy*., *Commissioner of Internal Revenue v. Ames Trust & Savings Bank, supra,* 49.

[17]The Commissioner of Internal Revenue's argument here is only based in part on similarity of economic function. It is also based on two cases construing the term "bank," as defined in §104 (a) for the specific purpose of § 104(b). *Morris Plan Bank of New Haven v. Smith* (2nd Cir. 1941), 125 F.2d 440; *Staunton Industrial Loan Corp. v. Commissioner of Internal Revenue* (4th Cir. 1941), 120 F.2d 930. It is somewhat difficult to determine the precise purpose the Commisisoner had in resurrecting these cases unless it be his need for some colorable authority. It may be suggested that the cases cited involve a very different statute (§104(b)) having a very different purpose from § 439(b) and that the cases cited also involve (despite a similarity of *name* in the one case) very different organizational structures from that presented here.

(2) More to the point, the Commissioner argued that there are no substantial distinctions between Thrift Certificates and Certificates of Deposits issued by a *bank* in connection with a time savings account.

Both of these arguments were accepted by the Court of Appeals for the Ninth Circuit in this case:

> "The transactions [in this case] have none of the characteristics of money borrowing for the purposes of a business as contemplated by § 439 of the Excess Profits Tax Act. Such transactions are like deposits and, in fact, are deposits." (p. 25)
>
> "We conclude from the foregoing that [petitioner] is a bank as defined by § 104 of the Internal Revenue Code of 1939, as amended." (p. 28)

The Court of Appeals in the *Jackson Finance Company* case, a case squarely in point and involving an industrial loan company organized under the laws of Utah, affirmatively rejected the same two arguments:

> " 'Bank' and 'bank deposit' are terms as well known in common parlance as they are in technical commercial use. And the terms do not include industrial loan companies nor monies received by sale of thrift certificates either in actual or technical understanding. Money paid for thrift certificates (or other evidences of indebtedness whatever called) are intended as investments, influenced largely by the promise of payment of a high rate of interest . . ."
>
> *Jackson Finance & Thrift Co. v. Commissioner of Int. Rev.*, 260 F.2d 578, 582.

Similarly, in a case involving the same question as applied to a saving and loan company's certificates, *United States v. City Loan and Savings Company* (1961), 287 F.2d 612, the Court of Appeals for the Sixth Circuit concluded:

> "The deposits of taxpayer were not similar to those of a bank in that withdrawal was subject to provisions of its bylaws. Bank deposits on the other hand are treated as cash and may be withdrawn on demand unless they provide for a fixed term. Taxpayer was not a bank, but a building and loan company. A bank would not be classified as a building and loan company simply because it made loans on real estate."[18]
>
> *United States v. City Loan and Savings Company*, 287 F.2d 612, 615.

At no time has the Government suggested that the *Jackson Finance* case presents fact distinguishable from the present case. See Brief for the Petitioner, U.S. Court of Appeals for the Ninth Circuit, No. 17135, pp. 45-47. Similarly, the Court of Appeals for the Ninth Circuit expressly rejected *Jackson Finance:*

> "The determinative conclusion of the Court of Appeals of the Tenth Circuit in Jackson that the certificates there under consideration were intended to be evidences of indebtedness to a pur-

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[18] In *Economy Savings & Loan Co.* (1945), 5 T.C. 543, 551, *modified on other grounds* (6th Cir. 1946), 158 F.2d 472, the Tax Court said:

> "Respondent's suggestion that petitioner was really in the banking business and that the funds evidenced by the certificates herein involved are analogous to the deposits of a bank is not borne out by the evidence."

> chaser who has invested, and has intended to invest, in a corporate security rather than make a deposit for safekeeping, is not supported by reason and has no application to the present case." (p. 23)

Although the Court of Appeals for the Ninth Circuit failed to mention the *City Loan and Savings Company* case, this case is also squarely in point and contrary in its holding to the decision of the Court of Appeals here. Judge Weick, writing for the Court of Appeals for the Sixth Circuit, considered *Economy Savings and Loan Co., supra; Jackson Finance & Thrift Company v. Commissioner of Internal Revenue, supra; Valley Morris Plan Company*, 33 T.C. 572 and *Morris Plan Company of California*, 33 T.C. 720, as the controlling authorities. 287 F.2d, at 614-615. The last two of these cases, of course, are the very cases reversed in the Court of Appeals decision for which review is now sought.

The major substantive question presented by petitioner is, therefore, one as to which a clear conflict exists between the Courts of Appeals for the Sixth and Tenth Circuits on the one hand, and for the Ninth Circuit, on the other.

The Question Is an Important One, Having a Substantial Fiscal Impact.

2. It also presents a problem in statutory construction which constitutes "an important question of Federal law which has not been, but should be, settled by this court." The importance of this question cannot be better expressed than by a quotation from the Pe-

tition for Certiorari of the Government in *Jarecki v. G. D. Searle & Co.* (1960 Term No. 151, p. 6):

> "The question in this case, . . . presents an important problem in the administration of the . . . provisions of the Korean War excess profits tax law—which are just now beginning to reach the appellate level in litigation, and can reasonably be expected to follow an increasing volume in the future. . . ." (Footnotes deleted.)[19]

A time lag between taxable years to which a federal taxing statute applies and the year in which disputes in connection with such a statute finally reach appellate courts is unavoidable. It is inherent in our system of self-assessment and extensive administrative review. Such a time lag should not prejudice taxpayers; they are entitled to the same guarantee of final uniformity of decision throughout the nation as is accorded to litigants in other kinds of cases. They are to that degree entitled to review in this Court.

Cases such as these generally involve very substantial amounts of tax. That fact is relevant not only to a consideration by this Court of the importance of such cases to the Federal Government, but also in this Court's consideration of the importance of this case, and of a right decision in this case and cases similar to it, to petitioner as a taxpayer and to taxpayers generally. Petitioner in this case stands to lose

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[19]Certiorari was granted in this case. *Jarecki v. G. D. Searle & Co.*, 364 U.S. 812, 5 L.Ed.2d 45 (1960). And the Government succeeded in having judgment reversed in this Court. *Jarecki v. G. D. Searle & Co.*, 367 U.S. 303, 6 L.Ed.2d 859 (1961).

$265,000.00.[20] Since petitioner does not have the facilities and information available to the Government, petitioner is not in a position to present statistics on the true fiscal impact of the exercise of this Court's jurisdiction in this case. However, the amounts involved in petitioner's case alone suggest the substantiality of that fiscal impact.

The Error Below Is an Egregious One.

The second question presented by petitioner is alternative to the first. This Court has very often, and very properly, insisted that it is not primarily concerned with the correction of errors in lower courts' decisions. STERN & GROSSMAN, SUPREME COURT PRACTICE (2d Ed.), pp. 107; 127-130. The Rules of this Court contain, however, a salutary exception to that insistence; this Court will exercise its jurisdiction in every case where the lower court "has so far departed from the accepted and usual course of judicial proceedings . . . as to call for an exercise of this Court's powers of supervision." In the particular circumstances of this case and in light of the opinions accompanying the Ninth Circuit's decision in this case and its decision to deny rehearing in this case, petitioner believes that this is a case in which this Court should exercise jurisdiction.

The extraordinary elements justifying that exercise of jurisdiction are set forth rhetorically in the second

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[20]Petitioner itself has a dispute concerning its taxes for the taxable year 1953 and involving this same question That dispute alone involves $89,000 worth of taxes. In the absence of a uniform national rule, petitioner's remedy can only be to pay the disputed taxes and then to sue for a refund in the Court of Claims.

question as presented by petitioner. The first such element stems from the administrative background of this case. In 1945, under the admittedly similar provision of the World War II Act, the Commissioner of Internal Revenue affirmatively published his acquiescence in the holding of *Economy Savings and Loan Company, supra* (see fn. 10, *supra*). The meaning of that acquiescence was clear. In petitioner's case, as the evidence offered by petitioner and the Tax Court showed, petitioner's expert advisors understood the Commissioner's acquiescence in *Economy* as a clear indication that, under the 1950 Act, an industrial loan company like petitioner could safely finance its business through the sale of its Thrift Certificates without adverse tax consequences. Petitioner's evidence on this point further showed that petitioner could have increased its bank borrowing—clearly includable in its "borrowed capital"—during the years in question, but did not do so in reliance on advice that proceeds of Thrift Certificates were equally so includable. As a result of that justified reliance, petitioner stands to pay additional taxes of more than $265,000. This retroactive change of administrative opinion is not to be classified as a mere correction on a question of law. *Cf. Automobile Club v. Commissioner*, 353 U.S. 180, 183-184, 1 L.Ed.2d 746, 750. The true nature of the Commissioner's change of opinion was set forth by Judge Kloeb in *City Loan and Savings Company v. United States* (N.D. Ohio 1959), 177 F.Supp. 843, 851:

> "The doctrine of equitable estoppel does not bar correction by the Commissioner of Internal Revenue of a mistake of law, but in this case it does

> not appear that there was a mistake of law, a mistake of fact, or other lawful excuse for the Commissioner to change his position, to the prejudice of the taxpayer, merely because the Commissioner entertained a different view or change of opinion in 1957, or a 'matured and better judgment' of the same factual situation which existed in 1945."

A second element which justifies the exercise of this Court's jurisdiction involves the opinion of the Court of Appeals itself. On page 28 of the Court's opinion, the following is stated as one of the grounds of decision:

> "We conclude from the foregoing that each of the institutions here is a bank as defined by Section 104 of the Internal Revenue Code of 1939, as amended."

However, one of the definitional elements of a "bank" in that section (set forth in fn. 13, *supra*) is that the institution be "subject by law to supervision and examination by State, Territorial or Federal authority having supervision over banking institutions." But it is stipulated in the record that petitioner "at all times material [hereto] was and is subject to regulation by the Commissioner of Corporations of the State of California." Moreover, the uncontroverted evidence in the record shows that the Commissioner of Corporations does not supervise, regulate or control state banks, national banks or national banking associations. Despite the clear reference to state law as controlling

made in the federal statute itself, the Court of Appeals—when the above fact was pointed out to it on petition for rehearing—stated that:

> "California's statutory choice based upon state criteria of exercising control by different authority over similar institutions cannot bring these petitioners without the confines of the definition of 'banks' for federal tax purposes where the pertinent characteristics of the petitioner institutions are in substance the same as banks."

The statutory provision refers clearly to state law as the measure of the "State . . . authority having supervision over banking institutions. . . ." The statute as the Court of Appeals reads it would have to contain this language: "State . . . authority having supervision over . . . institutions [which in the judgment of a federal court function as banks]." Such an interpolation is an admission that the very statute the court inappropriately relied on was not sufficient to sweep in an institution such as petitioner.

These elements of retroactivity in the application of law and of manipulation of inappropriate concepts form the background of petitioner's alternative basis for asking this Court to grant certiorari. But against that background is set the fact that the Court of Appeals for the Ninth Circuit in this case failed to give due deference to the findings of the Tax Court or to the legal position already settled in the Courts of Appeals for the Tenth and Sixth Circuits.

It is often the case under the Federal Tax laws that the construction of a statutory term depends more on common sense and colloquial usage than on legal categorization. And this may be so whether the ques-

tion be considered one of "law" or one of "fact." Such is the instant case. Here the statutory touchstone is "certificate of indebtedness." The Commissioner has derived from limited indications of Congressional intention (see *Commissioner of Internal Revenue v. Ames Trust & Savings Bank* (8th Cir. 1950), 185 F.2d 47, 49) his regulation excluding from that term all instruments evidencing bank deposits, limiting it to instruments having the *general character* of investment securities. In defining a "bank deposit," however, the courts and the Commissioner have had to look to experience rather than to any bright-line distinction that legal analysis might give. Accordingly, as in *Duberstein*, "primary weight in this area must be given to the conclusions of the trier of fact." *Commissioner of Internal Revenue v. Duberstein*, 363 U.S. 278, 289, 4 L.Ed.2d 1218, 1227.

This "primary weight" the Court of Appeals did not give. The somewhat troubled history of the law in this area (since the Commissioner's turn-about in 1953) indicates with special force what conclusiveness should be given to the ultimate findings of fact of the Tax Court. That conclusiveness is especially justified where the Tax Court has reached one decision (*Jackson Finance & Thrift Company, supra*), but, as the Tax Court says in this very case, "after restudying the whole question, has come to [its final and opposite] conclusion."

The contention of the petitioner goes further: Two Courts of Appeals have already come to the conclusion that the position that the Government has reiterated since its turn-about in 1953 is without merit. In the view of those Courts, petitioner's Thrift Certificates are includable in petitioner's borrowed capital. This

is also the conclusion of the Tax Court of the United States. This Court, it is true, functions to secure ultimate uniformity of judgments throughout the nation; but no federal court is without due responsibility to consider uniformity a value in reaching judicial decisions. Scholars have concluded that it is no longer possible to say that this Court grants certiorari as of course in every case where there is a square conflict between the Circuits. See Stern, *Denial of Certiorari Despite a Conflict*, 66 HARV. L. REV. 465 (1953). That fact makes more important and grave the duty of lower federal courts to consider uniformity as a value. That value was here rejected. Petitioner believes it was wrongly rejected. It is just in the proportion that this Court may be unwilling to grant certiorari to resolve this particular conflict of statutory interpretation that rejection of the value represented by national uniformity of the law by the Court of Appeals for the Ninth Circuit becomes improper.

Conclusion.

The Court of Appeals for the Ninth Circuit, in deciding adversely to petitioner, departed from a statutory construction settled in the Tax Court and upheld in the Courts of Appeals of two Circuits. It also created a direct and irreconcilable conflict among the Circuits. The point as to which conflict exists is an important one. For these reasons as well as the others set forth above, certiorari should be granted.

Respectfully submitted.

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APPENDIX A.

Opinion of the Court of Appeals.

Before: HAMLIN and MERRILL, Circuit Judges, and

FOLEY, District Judge

FOLEY, District Judge:

We have before us two separate petitions to review two decisions of the Tax Court of the United States. With one exception, an identical question was involved and while the cases were briefed separately, they were united for argument. We will endeavor to dispose of them in a single opinion.

The exception is the alternative issue raised in the Morris Plan Company of California case.

Jurisdiction is conferred by § 7482 of the Internal Revenue Code of 1954, 26 U.S.C.A. § 7482.

The identical question presented in each of the cases as it appears in the briefs of the Commissioner of Internal Revenue is:

> "Whether the Tax Court erred in holding that thrift certificates representing sums placed in a Morris Plan Company are certificates of indebtedness and thus includable in borrowed capital for excess profits tax purposes within the meaning of Section 439(b)(1) of the Internal Revenue Code of 1939."

The Valley Morris Plan case involves the same question:

> "Did the Tax Court correctly hold that the indebtedness of the respondent California industrial

loan company evidenced by its outstanding Term Thrift Certificates was allowable as borrowed capital in computing its excess profits credit * * *?"

The same question was referred to in the brief of the Morris Plan Company of California as follows:

"Whether the Tax Court correctly held that the indebtedness of Respondent California industrial loan company evidenced by its outstanding thrift certificates constituted 'borrowed capital' within the meaning of Section 439(b)(1) of the Internal Revenue Code of 1939, as amended."

So we have in each case as the first issue to be determined substantially the same question.

As noted by the petitioner, there is a difference of fact. In Valley Morris Plan Term Thrift Certificates are involved, while in the California Morris Plan case we are, in the main, concerned with Installment Thrift Certificates. From our review of the cited cases we feel that this difference is of no consequence.

As explanatory of the matters which are involved in both cases, we refer to the statement of petitioner in Valley Morris that:

"This case draws in question the meaning of certain terms used in Section 439(b)(1) of the Internal Revenue Code of 1939, and Section 40.439-1(f) of Treasury Regulations 130, issued thereunder. Section 439 was enacted by Section 101 of the Excess Profits Tax Act of 1950, which added a new Subchapter D to Chapter 1, the income tax chapter, of the Internal Revenue Code of 1939, to provide additional income taxes on excess profits of corporations. Generally speak-

ing, excess profits are measured by an excess over a 'credit' representing normal profits. * * *

"We are concerned here with the excess profits tax credit based on invested capital, as indicated by Section 436 and related sections. Section 437 (b) defines the elements of invested capital to include 'equity capital' and '75 percentum of the average borrowed capital for the taxable year computed under Section 439(a).' 'Equity capital is in general the total of assets less liabilities. Section 437(c). Section 439(a) defines average borrowed capital in terms of daily borrowed capital and subsection 439(b)(1) defines daily borrowed capital * * *."

Section 439(b)(1) of the Excess Profits Tax Act of 1950 is:

"§ 439. BORROWED CAPITAL.

"(a) * * *

"(b) DAILY BORROWED CAPITAL. For the purposes of this subchapter, the daily borrowed capital for any day of any taxable year shall be determined as of the beginning of such day and shall be the sum of the following:

"(1) The amount of the outstanding indebtedness (not including interest) of the taxpayer, incurred in good faith for the purposes of the business, which is evidenced by a bond, note, bill of exchange, debenture, certificate of indebtedness, mortgage, deed of trust, bank loan agreement, or conditional sales contract. In the case of property of the taxpayer subject to a mortgage or other lien, the amount of indebted-

ness secured by such mortgage or lien shall be considered as an indebtedness of the taxpayer whether or not the taxpayer assumed or agreed to pay such indebtedness, plus * * *."

Treasury Regulation 130, § 40.439-1(f), defining the ter· 'certificate of indebtedness" is the following:

"(f) The term 'certificate of indebtedness' includes only instruments having the general character of investment securities issued by a corporation as dinstiguishable from instruments evidencing debts arising in ordinary transactions between individuals. The term 'conditional sales contract' means a contract corresponding to a mortgage except that the transfer of title is made dependent upon the payment of the stipulated price. Borrowed capital does not include indebtedness incurred by a bank arising out of the receipt of a deposit and evidenced, for example, by a certificate of deposit, a passbook, a cashier's check, or a certified check, and the term 'bank loan agreement' does not include the indebtedness of a bank to a depositor."

The decision of the Tax Court in Valley Morris was:

"Ordered and Decided, that there is no deficiency or overpayment in income and excess profits taxes for the year 1951, there is a deficiency in income and excess profits taxes for the year 1952 in the amount of $1,494.40, and there is an overpayment in income and excess profits taxes for the year 1953 in the amount of $157.30, which amount was paid within three years before the mailing of the notice of deficiency, which notice

of deficiency was mailed within three years from the time the return was filed by the taxpayer."

In its opinion the Tax Court stated:

"The only issue for decision in this case is whether the petitioner [Valley Morris Plan, respondent here] is entitled, in computing its excess profits credit under section 439(b)(1), to include in the computation of its borrowed capital the amount of its outstanding 'Term Thrift Certificates.' It is not claiming here that the amount due on its 'Installment Thrift Certificates' should be included in the computation of its borrowed capital. It states that no excess profits taxes will be due if its outstanding indebtedness on its Term Thrift Certificates is included in the computation of borrowed capital."

As found by the Tax Court the "full Paid Term Thrift Certificates" for the periods here in question were issued on printed forms in denominations of $500 and $1,000. The front side of a $1,000 certificate is as follows:

"[Term Thrift Certificate—front]

TERM THRIFT CERTIFICATE

Number Face Amount

"T $1000

[Crest]

"hereinafter called 'Company,' certifies that

and/or

is the Registered Owner, hereinafter called 'Owner,' of this Term Thrift Certificate, which is payable according to the following terms and conditions:

"A. Payment shall be made to Owner at the current Redemption Value as shown on the Table of Redemption Values hereon, upon presentation of this Certificate, properly endorsed, at the office of Company in the City of Stockton, State of California.

"B. Company shall pay, upon request to the personal representative of the estate of Owner, in the event of his death prior to the Maturity Date hereof, the Face Amount together with interest from the date prior to the Maturity Date hereof, the Face Amount together with interest from the date hereof at the rate of four (4%) per cent per annum compounded semi-annually in lieu of the current Redemption Value.

"C. Company shall pay to owner, upon the maturity of this Certificate the excess of the then current Redemption Value over the Face Amount hereof. Thereupon, the Certificate shall be automatically renewed for a six (6) month period from its Maturity Date. Company shall pay Interest upon the Face Amount at the rate of four (4%) per cent per annum to Owner at the new Maturity Date; and, thereupon, this Certificate shall be automatically renewed for an additional six (6) month period. Such payments of interest and renewals shall continue until this certificate shall be presented for payment. If payment be made at any time other than Maturity Date, Company shall not be obligated to pay any interest for the current six (6) month period.

"D. Company may, at its option, (a) require thirty (30) days Notice of request for payment

in writing; and (b) limit the aggregate amount of payments for redemption of its Thrift Certificates of all classes in any one calendar month to an amount not exceeding its net receipts in the previous calendar month, and, in this case, Certificates shall be paid in the order in which they are presented therefor. Notwithstanding the foregoing, the entire amount payable hereunder together with accrued Interest at the rate of four (4%) per cent per annum compounded semi-annually shall be payable not later than six (6) months from the date of the giving of said Notice of request for payment.

"E. This Certificate may be registered in the names of two or more persons, or the survivor or survivors thereof. In this event, payment of the Face Amount or Interest to any one of said persons is in full discharge of Company's liability hereon in the amount so paid.

"F. Company may redeem this Certificate at any time by paying the Face Amount together with Interest from the date hereof at the rate of four (4%) per cent per annum compounded semi-annually unto Owner, provided Company gives unto Owner a notice of its intention so to do. Said notice must fix a definite date of payment which shall be not less than thirty (30) days nor more than sixty (60) days from date of delivery of same. Company shall not be obligated to pay any interest after the date of said redemption so fixed. "Said notice shall be deemed delivered when deposited in the United States Post Office, at Stock-

ton, California, enclosed in an envelope addressed to Owner at his last known address as given by him unto Company, with postage prepaid.

"G. This Certificate is registered in books kept at the office of Company and is transferable only upon its presentation at said office with a written form of assignment acceptable and delivered to Company duly executed by the person appearing to be the Owner hereof.

"H. In the event of the loss of this Certificate and upon proof thereof in a manner satisfactory to Company, Company may issue unto Owner a new Certificate identical with this in form; or, at the option of Company, Owner may be required to follow the requirements of the Statutes of the State of California then in force relating to lost documents.

"In Witness Whereof, Valley Morris Plan has caused this Certificate to be signed by its duly authorized officers and its corporate seal affixed this ..... day of .....19 .....

Valley Morris Plan

"Maturity Date:

.....day of ...., 19.....

.....

"THIS IS NOT A CERTIFICTE OF DEPOSIT

* * *"

Among others, the following claimed errors are assigned:

"The Tax Court erred:

"1. In holding and deciding that taxpayer's [respondent's] obligations evidenced by its term 'thrift and installment thrift certificates' constitute borrowed capital within the meaning of Section 439 of the Internal Revenue Code of 1939 (as amended by Section 101 of the Excess Profits Tax Act of 1950).

* * *

"3. In holding and finding that the taxpayer was not a 'bank' [for the purposes of the Excess Profits Tax Act of 1950].

"4. In failing to hold and find that the taxpayer was engaged in activities of a bank and was such for federal income tax purposes."

Petitioner argues that:

"The Tax Court erred in holding that the Thrift Certificates of a Morris Plan Company represent borrowed capital in the form of certificates of indebtedness of a corporation within the meaning of Section 439(b)(1) of the Revenue Act of 1939."

That the Tax Court so held appears from the following excerpts of Judge Murdock's opinion:

"Section 439 of the Internal Revenue Code of 1939 was added by section 101 of the Excess Profits Tax Act of 1950 and applies to all taxable years ending after June 30, 1950. * * *

"The only issue for decision in this case is whether the petitioner [respondent here] is en-

titled, in computing its excess profits credit under section 439(b)(1), to include in the computation of its borrowed capital the amount of its outstanding 'Term Thrift Certificates.' It is not claiming here that the amount due on its 'Installment Thrift Certificates' should be included in the computation of its borrowed capital. It states that no excess profits taxes will be due if its outstanding indebtedness on its Term Thrift Certificates is included in the computation of borrowed capital.

"The petitioner's [respondent's here] indebtedness on the Term Thrift Certificates was incurred in good faith for the purpose of its business, and the question is whether it was 'evidenced' by one of the items mentioned in the above quoted portion of section 439(b)(1). This question narrows under the arguments of the parties to whether the Term Thrift Certificate might fairly be regarded as a 'certificate of indebtedness' within the meaning of the section.

"The Commissioner has provided in Regs. 130, Section 40.439-1(e) and (f) that—

"* * * The name borne by the certificate is of little importance. More important attributes to be considered are whether or not there is a maturity date, the source of payment of any 'interest' or 'dividend' specified in the certificate (whether only out of earnings or out of capital and earnings), rights to enforce payment, and other rights as compared with those of general creditors.

"The term 'certificate of indebtedness' includes

only instruments having the general character of investment securities issued by a corporation as distinguishable from instruments evidencing debts arising in ordinary transactions between individuals. * * * Borrowed capital does not include indebtedness incurred by a bank arising out of the receipt of a deposit and evidenced, for example, by a certificate of deposit, a passbook, a cashier's check, or a certified check, and the term 'bank loan agreement' does not include the indebtedness of a bank to a depositor.

"The petitioner was not a bank and was prohibited from receiving deposit. Its Term Thrift Certificates were not certificates of deposit. Those certificates have a maturity date, usually three years after issuance. The interest specified in the certificate was to be paid in any event and was not limited to payment out of earnings. The certificates were not 'instruments evidencing debts arising in ordinary transaction between individuals' but were distinguishable from such instruments in much the same ways as are 'instruments having the general character of investment securities issued by a corporation.' They were issued by a corporation under express authority of the Department of Investment. They represented investments by the holders of the certificates. They were similar in many respects to the types of evidences of indebtedness listed in section 439(b)(1). It is difficult to exclude these certificates from borrowed capital under section 439(b)(1) even under the Commissioner's regulations, although their pay-

ment was not secured by a lien on any particular property of the petitioner or by any designated cash reserve but was payable generally from the funds of the petitioner."

In *Commissioner of Internal Revenue v. Ames Trust & Savings Bank*, 8 Cir., 185 F.2d 47, 48, the Court said:

"[1] The Tax Court regarded a time certificate of deposit as constituting a certificate of indebtedness within the meaning of the statute and also said that it had the general character of an investment security required by the regulation. 12 T.C. pages 772, 773. In order, however, to escape the effect of the express provision of the regulation that 'Borrowed capital does not include indebtedness incurred by a bank arising out of the receipt of a deposit and evidenced, for example by a certificate of deposit, a passbook, a cashier's check, or a certified check,' the Tax Court declared that 'Under the principle of noscitur a sociis [it is known from its associates] the association of certificates of deposit with passbooks and checks satisfies us that what was referred to was a certificate of demand deposit.'

"This seems to us in the circumstances a strained search for meaning and an artificial construction of the regulation. The regulation makes the clear and substantive prescription that 'Borrowed capital does not include indebtedness incurred by a bank arising out of the receipt of a deposit * * *.' It then sets out some of the forms in which deposit transactions may be clothed or 'evidenced,'

such as certificates of deposit, passbooks, cashier's checks and certified checks, for the purpose, as we think apparent on its face, of simply emphasizing that, even though so clothed, deposit transactions cannot be regarded as borrowed capital. The enumerated forms are given merely in illustration, as the language 'for example' directly indicates.

"On all of this, we can see no basis in interpretive function for saying that the term 'a certificate of deposit' must be construed to not have its full and natural scope in the regulation and that the general substantive prescription of the regulation, that the deposit liabilities of a bank cannot be classed as borrowed capital, should correspondingly be curbed and be held to be intended to have application only to demand deposits.

"[2] Nor is the distinction which the Tax Court made between time certificates and demand certificates as reflecting obligations of different type or effect one that has any other recognized basis of support, either in banking law or banking concept. Legally, deposits on time certificates constitute a part of the deposit liability of a bank, just as much as those on demand certificates or in general checking accounts, and are regulated as such. Thus, for example, the Iowa statutes fix reserves for both the time and demand deposits of a state bank. Code of Iowa 1946, § 528.69, I.C.A. And in business operation, time certificates equally with demand certificates are carried on the books and statements of a bank as deposit liabili-

ties, in distinction from borrowings and other obligations—just as the record shows, from the reports of the bank to the Federal Reserve Bank, had been done here. Also, such certificates of a bank are treated the same as its demand certificates are, for purposes of deposit protection by the Federal Deposit Insurance Corporation, 12 U.S.C.A. § 246(e)(12), of which this bank was a member.

"[3] Hence, neither on the language of the regulation nor as a matter of legal status or banking concept, are we able to see any basis for construing the regulation as the Tax Court did. The only question therefore that could possibly exist in the situation is whether the regulation, in providing that deposit transactions of a bank, even though represented by certificates of deposit, do not constitute a borrowed-capital indebtedness, is violative of the statute and so is invalid. We do not believe that the regulation is out of harmony with the statute.

* * *

"[5] Historically and recognizedly, bank deposits have never been regarded as representing 'borrowed capital,' within the commercial connotation of that term. As the Iowa Supreme Court said in Elliott v. Capital City State Bank, 128 Iowa 275, 276, 103 N.W. 777, 778, the term 'deposit' always has had a meaning of its own, 'peculiar to the banking business, and one that the courts should recognize and deal with according to commercial usage and understanding.' And such a transaction is without any of the characteristics of money borrowing. Certainly there is no intent

on the part of an ordinary depositor to make a general loan to the bank. Nor is a bank permitted to deal with deposits as general loans, for the law, through legislative or administrative regulation, imposes limitations upon the manner and extent of the use of such funds, different from those on capital investment or borrowings. Also, as we have indicated, the distinction between deposit liabilities and other indebtedness is recognized by the banks themselves in their records and operations.

"That this inherent and established distinction between deposit liability and commercial indebtedness, which has been carried into the regulation, was intended to exist under the statute would seem furthermore to be pointed to by the joint hearings upon the bill. A representative of the American Bankers Association sought to have the bill provide that deposit liabilities should constitute borrowed capital, but members of the Committee voiced disagreement with his attempted analogy between deposits and borrowings, and the Committee did not approve any such change. * * *

"[6, 7] * * * We should perhaps add that we do not consider Economy Savings & Loan Co. v. Commissioner, 5 T.C. 543, affirmed on other grounds, 6 Cir., 158 F.2d 472, cited by the Tax Court and relied upon by the bank here, as being in any way applicable to the present situation. Under the contract governing the dealings of the parties, the funds received by the loan company in that case were not of the nature of a deposit transaction with a bank, as the court itself there recog-

nized, in saying that 'Respondent's suggestion that petitioner was really in the banking business and that the funds evidenced by the certificates herein involved are analogous to the deposits of a bank is not borne out by the evidence.' "

It will be noted that in the Iowa case, *Elliott v. Capital City State Bank,* cited above, it was held that the bank deposits were transactions without any of the characteristics of money borrowing, there being no intent on the part of an ordinary deposit or to make a general loan to the bank. Was the purchase of one of respondent's thrift certificates a transaction having any of the characteristics of money borrowing, and was there any intent on the part of purchasers of respondent's thrift certificates to make a general loan to respondent? If not, it seems illogical to hold that money received from the sale of such thrift certificates should be considered as borrowed capital for the purposes of the business. If there was such an intent on the part of purchasers of thrift certificates, and if the thrift certificates were purchased with the idea in the mind of the purchasers to loan money to respondent for the purposes of respondent's business, it seems fair to say that it would have been an easy matter for respondent to produce at the hearings before the Tax Court the testimony of purchasers of thrift certificates to that effect. From the fact that a search of this record discloses no such testimony, it may be inferred that no witness could have been found who would testify that it was his intent in the purchase of a thrift certificate to loan money to respondent "in good faith for the purposes of the business" of respondent.

There is no testimony in the record from any of the purchasers of Term Thrift Certificates as to an intention to make a loan for the purposes of the business to respondent and we have failed to find any other testimony or evidence of such an intention. The certificates themselves, as shown by the form thereof included in the findings, disclose no purpose or intent of the purchasers to make a loan at the request of respondent for purposes of respondent's business.

What we have just above said as to the intention of purchasers of thrift certificates is applicable to the Morris Plan Company of California case, there being no evidence in the record in that case as to an intention of any purchaser of an Installment Thrift Certificate to make a loan for the purposes of the business.

We should keep in mind the manner in which thrift certificates are acquired by purchasers or owners. Respondent, after having acquired a permit from the state authority, advertises to the public that it has certificates for sale. On their face the forms of thrift certificates indicate the rate of interest to be paid to a purchaser of such certificates. In response to such advertising a person desiring to obtain a Term Thrift Certificate comes to the respondent's place of business, states the amount desired and the name or names in which he desires a certificate or certificates issued and delivers cash to the respondent equal to the face amount of the certificates issued. This is an accurate description of the entire transaction between respondent and a purchaser of respondent's thrift certificates. Such a transaction is nothing more nor less

than a deposit transaction, the money to be kept safely for the purchaser and to be repaid according to the terms of the certificate with interest.

It seems obvious that something more would be required to render such a transaction a loan to respondent for the purposes of respondent's business. The usual definition and understanding of what constitutes a loan is stated by the District Judge in *National Bank of Paulding v. Fidelity & Casualty Company and Maryland Casualty Company,* 131 F.Supp. 121, 123. There Judge Cecil stated:

> "[1, 2] In order to have a loan, there must be an agreement, either expressed or implied, whereby one person advances money to the other and the other agrees to repay it upon such terms as to time and rate of interest, or without interest, as the parties may agree. In order to have a contract, there must be a meeting of minds."

This record does not disclose any agreement on the part of any purchaser of a thrift certificate to loan monies to respondent for the purposes of its business. The thrift certificate, by its terms, does not authorize respondent to use any of the money received from the sale thereof for any other purpose or in any other manner than banks apply and use money received in deposits.

The monies received from the sale of thrift certificates were used in the same manner as banks use monies received in deposits. That this is true appears

from the following testimony of Mr. Edwin B. Fuld, Valley Morris' president. He testified in response to a question on direct examination as follows:

"Q * * * In what manner does your company use the money that is obtained from the certificates?

"A The money is used in the transaction of our business.

"Q Which is what?

"A The business is two-fold: The making of loans and the purchasing of paper, of notes, conditional sales contracts, and other evidences of indebtedness.

"Q What other money is so used besides the amount you receive from the sales of certificates?

"A Our capital is used, and also bank loans."

Evidently on this testimony the Tax Court made its finding that:

"The money obtained by the petitioner on the issuance of certificates is used in its business in making loans and purchasing paper, notes, conditional sales contracts and other evidence of indebtedness. The only other money which the petitioner has available for business purposes is capital and money borrowed from banks."

Banks engage in the same business which we are informed by Mr. Fuld that the respondent is enganged in and they use depositors' money for the same purposes respondent uses the money derived from the sale of thrift certificates. And it should be noted that Mr. Fuld also testified that his institution competes with banks.

The respondent has failed to meet its burden of proof to establish that the money received from the sale of thrift certificates was borrowed for the purposes of the business.

The state law under which respondent was organized forbids it to accept deposits and at the conclusion of the form of the thrift certificate, in oversized capitals, appears the statement, "THIS IS NOT A CERTIFICATE OF DEPOSIT."

We have seen that the Tax Court found:

> "* * * It [respondent] was not a state or national bank."

and that

> "* * * [t]he petitioner has never represented itself as a bank, has never accepted deposits, does not issue certificates of deposit and is prohibited by law from issuing certificates of deposit."

The Term Thrift Certificates issued by respondent, regardless of the oversized letters to the contrary, quality [*sic*] as certificates of deposit.

Respondent must concede that a substantial part of its business was the advertising and selling to the public of thrift certificates. The money so received from thrift certificates did not constitute money borrowed for the purposes of respondent's business and the payments of money for which respondent issued its thrift certificates, either Term or Installment, were deposits.

As we have seen, Treasury Regulation 130, § 40.-439-1(f) provides that:

> "* * * Borrowed capital does not include indebtedness incurred by a bank arising out of the

receipt of a deposit and evidenced, for example, by a certificate of deposit, a passbook, a cashier's check, or a certified check, and the term 'bank loan agreement' does not include the indebtedness of a bank to a depositor."

We are not to be governed by state law in determining whether or not respondent was in fact a bank or that the monies received from thrift certificates, either Term or Installment, were deposits received by a bank.

On this subject and on other questions involved here, the Court of Appeals of the Second Circuit in *Morris Plan Bank of New Haven v. Smith, Collector of Internal Revenue;* 125 F.2d 440, had the following to say on p. 441:

"Sec. 104(a) of the Revenue Act of 1936 which establishes the rate of tax which the plaintiff contends should have been applied in the assessments for the years involved defines a 'bank' to which those rates shall be applied as follows: 'Definition. As used in this section the term "bank" means a bank or trust company incorporated and doing business under the laws of the United States (including laws relating to the District of Columbia), of any State, or of any Territory, a substantial part of the business of which consists of receiving deposits and making loans and discounts, or of exercising fiduciary powers similar to those permitted to national banks under section 11(k) of the Federal Reserve Act, as amended, and which is subject by law to supervision and examination by State or Federal authority having supervision over banking institutions.'

"The plaintiff was, during the years in question, plainly enough a bank as above defined if a substantial part of its business consisted of receiving deposits, for in other essential respects it admittedly fell within the definition. Nor was there any question but that a substantial part of its business consisted in the receipt of installment payments for which it issued the above described certificates of indebtedness which were never assigned to it as collateral security for loans. If the receipt of these payments was the receipt of deposits, therefore, the plaintiff was a bank as defined.

"[1] If the state law were decisive they could not be so treated for, after the plaintiff became an industrial bank under the laws of Connecticut, it was forbidden by that law to receive money on deposit though it was authorized by Sec. 4034 of the General Statutes of Connecticut, Revision of 1930, as amended, to sell certificates of indebtedness either fully paid or on the installment plan. But names are not what control. Morgan v. Commissioner, 309 U.S. 78, 81, 626, 60 S.Ct. 424, 84 L.Ed. 585. Realities do. The plaintiff took these payments under agreements which made them a part of its general funds and created only the relationship of debtor and creditor between it and the payer. It issued the certificates of indebtedness in form similar to that of deposit books used by savings banks. Payments and withdrawals were entered in them and these accounts were active. * * * Whether such payments are distinguished from deposits under state law is not con-

trolling in construing a federal taxing statute which does not expressly or by necessary implication make its application dependent upon what the law of a state may provide. Were it otherwise the varying laws of the states might well make impossible general uniformity of national taxation throughout the country. United States v. Pelzer, 312 U.S. 399, 61 S.Ct. 659, 85 L.Ed. 913.

"[2] * * * We conclude that the plaintiff is, therefore, a bank within the meaning of Sec. 104 of the Revenue Act of 1936 and entitled to be taxed accordingly. Compare, Staunton Industrial Loan Corporation v. Commissioner, 4 Cir., 120 F.2d 930.

"Judgment reversed."

In *Morgan v. Commissioner,* 309 U.S. 78, 81, cited by the Court in *Morris Plan Bank of New Haven v. Smith, Collector of Internal Revenue,* supra, the Supreme Court made the observation:

"State law creates legal interests and rights. The Federal revenue acts designate what interest or rights, so created, shall be taxed. Our duty is to ascertain the meaning of the words used to specify the thing taxed. If it is found in a given case that an interest or right created by local law was the object intended to be taxed, the Federal law must prevail no matter what name is given to the interest or right by state law."

The Supreme Court of the United States in *United States v. Pelzer,* 312 U.S. 399, declared that:

"* * * the revenue laws are to be construed in the light of their general purpose to establish a

nationwide scheme of taxation uniform in its application. Hence their provisions are not to be taken as subject to state control or limitation unless the language or necessary implication of the section involved makes its application dependent on state law."

There is nothing in § 439(b) of the Excess Profits Tax Act of 1950 which requires that a different meaning be given to a bank than that defined by § 104 of the Internal Revenue Code of 1939.

In a case upon which respondent places considerable reliance, *Jackson Finance & Thrift Company v. Commissioner of Internal Revenue,* 10 Cir., 260 F.2d 578, at page 582, it is recognized that the definition of the term "bank" in § 104 of the Internal Revenue Code of 1939 applies to the Excess Profits Tax Act. There the Court stated:

"Sec. 438(g) of the 1939 Code relates the term 'bank' as contained in Sec. 104 of that Code, 26 U.S.C.A. (I.R.C. 1939) § 104, to the excess profits tax * * *."

Sec. 438(g) of the Excess Profits Tax Act of 1950 contains the following:

"In the case of a bank (as defined in section 104), if the increase in total assets for the taxable year * * *."

Said § 104, as amended, reads:

"* * * As used in this section, the term 'banks' means a bank or trust company incorporated and doing business under the laws of the United States (including laws relating to the District of Colum-

bia), of any state, * * *, a substantial part of the business of which consists of receiving deposits and making loans and discounts, * * * and which is subject by law to supervision and examination by State, Territorial or Federal authority having supervision over banking institutions. Such term also means a domestic building and loan association. * * *"

Section 104 also finds its way into the Excess Profits Tax Act of 1950 in § 433(a)(1)(L):

"Bad debts in case of banks. In the case of a bank (as defined in section 104) * * *."

In *Sampsell v. Straub*, 9 Cir., 194 F.2d 228, 230, this Court held:

"[3] * * * Sec. 70, sub. c is not the only section of the Bankruptcy Act which mentions liens by legal or equitable proceedings. Identical or equivalent language appears in several sections of the Act, * * *. If there are reasons which require a certain construction of a phrase in one part of a statute, it is desirable, and presumably in accord with the intention of Congress that a similar construction be given that phrase elsewhere in the statute unless the context shows affirmatively that a different construction was intended."

The decision in the Jackson case appears to have been largely influenced by the state law of Utah. The following from the opinion, 260 F.2d 578, 581:

"[1, 2] At the time that Congress enacted the Excess Profits Tax Act of 1950 it failed to amend, revise or in any way alter the definition of borrowed capital as it was contained in the earlier World War

II Act except to add transactions evidenced by conditional sales contracts and bank loan agreements. At such time the judicial interpretation of the Tax Court in Economy [Economy Savings & Loan Co. v. Commissioner, 5 T.C. 543, affirmed on other grounds, 6 Cir., 158 F.2d 472], the administrative interpretation of the Treasury Department through regulation, and the formal acquiescence of the Commissioner in the holding of Economy were all part and parcel of the actual and effective administration of the earlier tax statute. The distinction between the deposit liability of a bank and the nature of a borrowing transaction such as we here consider had, in 1950, been recognized both judicially and administratively. By re-enacting the statutory definition of borrowed capital for purposes identical with that definition's original purpose it must be presumed that Congress both approved and intended to adopt the judicial and administrative interpretation and construction that had been placed upon its words by those responsible for statutory interpretation and administration. Such rule is a fundamental principle of statutory interpretation and is dispositive of the instant case unless successful contention can be made that a factual situation here exists which would put taxpayers within the rule applicable to banks. And such is the Commissioner's principal claim in argument before this Court although the Tax Court refused to pass on the merits of such contention.[4] Since

[4]"Opper, J., dissenting, stated: 'It seems to be impossible to dispose of this case on the authority of respondent's regulation without concluding that petitioner was a "bank"'."

the burden is upon taxpayers to prove that the deficiencies imposed upon them are wrong under any proper theory it is our duty to consider all contentions of the Commissioner that might sustain the contrary view. * * *

"Sec. 438(g) of the 1939 Code relates the term 'bank' as contained in Sec. 104 of that Code, 26 U.S.C.A. (I.R.C. 1939) § 104, to the excess profits tax and so defines bank thus:

> '* * *[1] a bank or trust company incorporated and doing business under the laws * * * of any State * * *, a substantial part of the business of which consists of receiving deposits and making loans and discounts * * * and which is subject by law to supervision and examination by State, Territorial or Federal authority having supervision over banking institutions.'

Under the law of Utah, industrial loan companies are subject to regulation through the supervision of the State Bank Commissioner and to this extent fall clearly within the definition of a bank as defined above. AND IT WOULD BE UNREALISTIC NOT TO NOTE THE MARKED SIMILARITY IN BUSINESS PROCEDURE BETWEEN THE INTAKE OF FUNDS BY A BANK THROUGH SAVINGS DEPOSITS AND THAT OF THE TAXPAYERS THROUGH THE ISSUANCE OF THE THRIFT CERTIFICATES. [Emphasis ours]. But it would be equally unrealistic not to note

[1]The portion of § 104 represented by asterisks is:
"(a) Definition. As used in this section the term 'banks' means"

that such similarity is limited to form and does not exist either in law or fact. Depositors place their money in banks primarily for safekeeping, secure in the knowledge that many governmental restrictions, both state and federal, are placed upon banks to assure and sometimes, as in the case of Federal Deposit Insurance banks, to insure the safety of the deposit. 'Bank' and 'bank deposit' are terms as well known in common parlance as they are in technical commercial use. And the terms do not include industrial loan companies nor monies received by sale of thrift certificates either in actual or technical understanding. Money paid for thrift certificates (or other evidences of indebtedness whatever called) are intended as investments, influenced largely by the promise of payment of a high rate of interest, here 4%, but with a concomitant risk. Bank deposits are made at a lower rate of interest, here 2½%, for safekeeping.

"[3] To preserve both the legal and actual concept of the term 'bank' and 'bank deposit' Utah has adopted many statutory safeguards so that the issuance of thrift certificates cannot be confused with banking functions. The certificates must state on their face: 'This is not a certificate of deposit.' Industrial loan companies are prohibited from using the word 'bank' or 'bank deposit' in their business. Now 7-3-57, Utah Code Ann. 1953. And they cannot accept deposits. Industrial loan companies cannot become members of the federal reserve system and are not eligible for deposit insurance with any federal agency. It seems clear that taxpayers are not banks, are not performing

banking functions, and are not receiving bank deposits through the issuance of their thrift certificates. Such certificates are, and are intended to be, evidences of indebtedness to a purchaser who has invested, and has intended to invest, in a corporate security rather than make a deposit for safekeeping. The judgments of the Tax Court are accordingly severally

"Reversed."

While recognizing the "marked similarity in business procedure between the intake of funds by a bank through savings deposits and that of the taxpayers through the issuance of the thrift certificates," the Court seems to assume that the purchasers of the thrift certificates in Jackson did not purchase the certificates primarily for safekeeping, and that assumption seems to be based entirely upon the conclusion of the Court that because of the fact that banks are subject to more stringent governmental restrictions than institutions of the type discussed, an individual would not be inclined to make a deposit with such an institution as was under consideration. The Court's conclusion that the purchasers of the thrift certificates were not depositors seems to rest upon this assumption that a purchaser of thrift certificates would not be held to be a depositor of the money represented by such a certificate for the slender reason that the money might be safer in a bank than in an institution such as was under consideration.

If it be the reasoning of the Court in the Jackson case that purchasers of the thrift certificates were not motivated by the purpose and desire of putting their money in a reasonably safe place, we cannot agree with

any such view. The fact that the purchasers of thrift certificates would receive 4% interest and that depositors in banks would receive but 2½% interest would not lure a reasonable individual to the extent that he would abandon the idea of obtaining a safe place for his money. The only reasonable conclusion is, that an ordinary individual purchasing a thrift certificate from this Utah institution would not enter into any such transaction if he did not believe the institution a reasonably safe place to place his funds.

The Jackson decision evidently is based, at least to a substantial extent, upon the following:

> That Utah has provided strong safeguards for those who deposit money in its banks;
>
> that, as in our case, under state law the thrift certificates must state on their face and do state on their face, "This is not a certificate of deposit";
>
> upon the fact that industrial loan companies, like respondent in our case, are prohibited by state law from using the word "bank" or "bank deposits" in their business;

and for these and other reasons or prohibitions defined by the Utah law, the Court could not see its way clear to define the institution it was considering as a bank and/or could not consider the money placed with it by sales of thrift certificates as deposits.

All these considerations must give way under the influence of the Federal law. As was explained in *Mor-*

ris Plan Bank of New Haven v. Smith, supra, the following quotation from that case will bear repeating here:

> "Whether such payments are distinguished from deposits under state law is not controlling in construing a federal taxing statute which does not expressly or by necessary implication make its application dependent upon what the law of a state may provide. Were it otherwise the varying laws of the states might well make impossible general uniformity of national taxation throughout the country."

The determinative conclusion of the Court of Appeals of the Tenth Circuit in Jackson that the certificates there under consideration were intended to be evidences of indebtedness to a purchaser who has invested, and has intended to invest, in a corporate security, rather than make a deposit for safekeeping, is not supported by reason and has no application to the present case. It cannot be said in this case, and there is no evidence in the record to support a conclusion that the purchasers of the thrift certificates of respondent were not motivated and largely influenced by the desire and purpose of obtaining a place of safekeeping for their money. And we find no such evidence in the record in No. 17135, Commissioner of Internal Revenue, Petitioner, v. Morris Plan Company of California, Respondent.

That the transaction involving the purchase of a thrift certificate issued by the Morris Plan Company

of California, and the withdrawal of a portion or all of the money paid for such certificate is similar to and almost identical with the procedure involved in deposits in a bank, appears from the following testimony of Mr. Ralph N. Larson, the president of that institution:

"Q Now, Mr. Larson, if a person wanted to open or obtain one of these installment accounts, just what would he do?

"A If he wanted to come in and buy an installment investment Thrift Certificate, he would come in and hand us X number of dollars and say, 'I want to purchase an Installment Investment Certificate,' and we would have him sign a signature card. We would have him sign this register card and then we would issue the booklet to him and he would walk out with it.

"Q That is he would approach a teller?

"A No, he would not. He would, the general practice is he would go to a man or woman sitting at a desk.

"Q And what if a person comes in and says, 'I want to open an account, I have $10,' then what happens?

"A We would follow that procedure.

"Q You fill out some sort of a record card?

"A We have him sign a registered card and a signature card and issued the Installment Certificate to him.

"Q Now, if I had $5 and wanted to open a savings account at your Upper Avenue Bank in Chicago, would I do anything differently?

"A No.

"Q Now, after the account is opened, and I have been fortunate enough to have about $50 in it and I want to go on a vacation, how do I get some of the money out?

"A Simply walk to a window in our cashier's department and say, 'I would like to take out a certain amount, X number of dollars.'

"Q That is, you walk up to a teller and then you tell them you want to withdraw some money?

"A That is correct, yes.

"Q You don't have to fill out any form?

"A Don't have to fill out anything. You simply sign your name on this register.

"Q In that one respect it is a little simpler than withdrawing it from a savings account where they might ask you to fill out some sort of withdrawal certificate?

"A It is a different procedure there, yes.

"Q Not materially different because you walk up to a teller anyway, and give him a book, isn't that about what it amounts to?

"A That is right.

"Q Now, on the Installment Certificates you state that you can add as little as you like and you can withdraw assuming you have funds in there; is that correct?

"A We always state in our advertising that we have always honored all withdrawals on request, yes."

The transactions evidenced by the above testimony have none of the characteristics of money borrowing for the purposes of a business as contemplated by § 439

of the Excess Profits Tax Act. Such transactions are like deposits and, in fact, are deposits.

In *Staunton Industrial Loan Corporation v. Commissioner of Internal Revenue*, 4 Cir., 120 F.2d 930, at the outset of its opinion, the Court said:

> "This is a petition to review the decision of the United States Board of Tax Appeals (hereinafter called the Board), wherein there was a redetermination of deficiencies in the income and excess profit taxes paid by the Staunton Industrial Loan Corporation."

The institution there involved is similar in many respects to those here under consideration. The Court dealt with problems similar to those we have to consider. We quote from the opinion beginning on p. 933:

> "[1] The laws of Virginia, for reasons which that State apparently thinks are compelling, draw a definite line between 'banks' and 'industrial loan associations'. However, we do not believe that the peculiarities in individual state laws are controlling on this court in the interpretation of section 104. * * * Hence, though a particular institution falls without the definition of a 'bank' as drafted by a state legislature, this same institution may well fall within the clear policy and broad definition stated by Congress.
>
> "[2] All of the business of petitioner consists of receiving deposits, specifically termed 'investments', and of making loans and discounts. Interest is paid on the deposits at a rate fixed by its Board of Directors. A legal rate of interest

is charged in advance upon the entire amount of the loans made. It is true that checks drawn on accounts in other institutions are not accepted as deposits, or so-called 'certificates of investment', and that petitioner has no authority to accept deposits subject to check. But money is withdrawn by depositors through the use of check-like forms furnished by petitioner. And though petitioner has a regulation which states that 'checks' are not to be drawn payable to persons other than the petitioner, petitioner, where this regulation is violated, does honor such checks when they are presented by endorsees at petitioner's place of business. There is no dispute over the fact that petitioner is subject by the law of the State of Virginia to supervision and examination by the very same authority which supervises within the State all commercial and other banking institutions, i.e., by the Banking Department of the Corporation Commission of Virginia.

"The sum total of petitioner's business activities indicates that petitioner comes within the classification set out in section 104 of a 'bank', and within the general meaning of that term. Bouvier's Law Dictionary * * * [Then follow definitions of a bank from Bouvier's Law Dictionary, Ballentine's Law Dictionary, Funk & Wagnalls New Standard Dictionary, and Black's Law Dictionary.]

"[3] A reading of these general definitions clearly reveals that the chief functions of a bank involve: (1) the receipt of deposits from the general public, repayable to the depositors on demand or

at a fixed time, (2) the use of deposit funds for secured loans, and (3) the relationship of debtor and creditor between the bank and the depositor. These seem to be the bare requisites; for, certainly, an institution may still be given the general classification of a 'bank' despite many other extensive and varied activities. Indeed, the title 'bank' will vary with differences in the purpose of classification. * * * In Oulton v. German Savings & L. Soc. 1872, 84 U.S. 109, * * *, Mr. Justice Clifford enunciated a definition of banks which has now become classic: 'Banks in the commercial sense are of three kinds, to wit: 1, of deposit; 2, of discount; 3, of circulation. Strictly speaking the term bank implies a place for the deposit of money, as that is the most obvious purpose of such an institution. Originally the business of banking consisted only in receiving deposits, such as bullion, plate, and the like, for safekeeping until the depositor should see fit to draw it out for use, but the business, in the progress of events, was extended, and bankers assumed to discount bills and notes and to loan money upon mortgage, pawn, or other security, and at a still later period to issue notes of their own intended as a circulating currency and a medium of exchange instead of gold and silver. Modern bankers frequently exercise any two or even all three of those functions, but it is still true that an institution prohibited from exercising any more than one of those functions is a bank in the strictest commercial sense * * *.'

* * *

"A 'bank' is defined in section 104(a) as 'a bank or trust company * * * doing business under the laws of the United States * * *, of any State, or of any Territory, a substantial part of the business of which consists of receiving deposits and making loans and discounts, or of exercising fiduciary powers similar to those permitted to national banks. * * *, and which is subject by law to supervision and examination by State or Federal authority having supervision over banking institutions.' We are of the opinion that the activities of petitioner bring it within the express terms of this statute, as well as within the commonly understood definition of a 'bank'. We are of the further opinion that the Board erred in concluding that the peculiarities of state laws were determinative of the instant issue.

"[4-7] This Court has often observed that taxation is concerned with realities and that, in considering tax matters, we are controlled by matters of substance and not of form. Cf. Dodge Brothers v. United States, 4 Cir., 118 F.2d 95, 102, 103 (C.C.A. 4th, 1941). Also, Weiss v. Stearn, 1924, 265 U.S. 242, 254, 44 S.Ct. 490, 68 L.Ed. 1001, 33 A.L.R. 520. By looking at the substance of petitioner's business transactions, we have been immediately led to the instant conclusion. We cannot accept the proposition that a special classification given by state law can so act as to withdraw an institution, which possesses the essential characteristics of a bank, from the protection afforded by the wording of, and the policy underlying, section

104. Furthermore, we are mindful that, wherever possible, federal taxing statutes are to be uniformly interpreted. Citing cases. As Mr. Justice Stone recently stated in United States v. Pelzer, March 3, 1941, 312 U.S. 399, 61 S.Ct. 659, 661: 'But as we have often had occasion to point out, the revenue laws are to be construed in the light of their general purpose to establish a nationwide scheme of taxation uniform in its application. Hence their provisions are not to be taken as subject to state control or limitation unless the language or necessary implication of the section involved makes its application dependent on state law.'

"We believe that the implication of section 104 does not make 'its application dependent on state law', and that our present conclusion is in accord with the views expressed above by Mr. Justice Stone. Any other conclusion might lead to results so weird that, under the argument ab inconvenienti, we cannot believe Congress intended these strange and contradictory results. The interpretation placed by the Board on section 104 might well result in levying this tax on substantially similar financial institutions in half of the States of the United States and in relieving from the tax these institutions in the other half of the States. We cannot lend our approval to an interpretation of a federal taxing statute which brings such things to pass.

"For the foregoing reasons, the decision of the Board is reversed."

We conclude from the foregoing that each of the institutions here is a bank as defined by § 104 of the Internal Revenue Code of 1939, as amended.

Our comments and the citations above have equal application to Valley Morris and Morris Plan of California.

The differences in the form or substance of the thrift certificates in each of these cases are of no consequence in determining the question whether the indebtedness evidenced by such certificates constituted borrowed capital within the meaning of § 439(b)(1).

The Tax Court erred in each of these cases:

1. In holding and deciding that respondents' obligations evidenced by their Term Thrift and Installament Thrift Certificates constitute borrowed capital within the meaning of § 439 of the Internal Revenue Code of 1939 (as amended by § 101 of the Exeess Profits Tax Act of 1950);

2. In failing to hold and decide that respondents' obligations evidenced by their Term Thrift and Installment Thrift Certificates do not constitute borrowed capital within the meaning of said § 439 of the Internal Revenue Code of 1939;

3. In holding and finding that respondents were not banks for the purposes of the Excess Profits Tax Act of 1950.

In view of our conclusion that the indebtedness evidenced by the thrift certificates of each of the respondents do not constitute borrowed capital, we will consider what respondent Morris Plan of California designates as its separate, distinct and alternative claim.

under § 444 of the Internal Revenue Code of 1939, as amended. As to this issue respondent states:

> "The separate and distinct alternative issue which need not be considered if the Court affirms the decision of the Tax Court is as follows: Whether Respondent, in computing its excess profits tax credit for the purpose of arriving at 'adjusted excess profits net income' subject to excess profits tax in the calendar years 1950, 1951, and 1952, is entitled to compute its average base period net income under Section 444(c) of the Internal Revenue Code of 1939, as amended, by reason of an increase in its capacity for production or operation as defined in Subsection (b)(3) of said Section 444 (i.e., whether Respondent increased its capacity for operation by additions to its 'facilities' such that its 'unadjusted basis' for determining gain upon sale or exchange of its total 'facilities', as defined in Section 444(d), on December 31, 1949, was 200% or more of such unadjusted basis on December 31, 1946)."

Petitioner states:

> "The Tax Court did not pass on this question because it had granted the taxpayer relief under Section 439."

However, it appears that the issue was considered. The Tax Court stated:

> "Your alternative contention for allowance of average base period net income and excess profits credit under Sections 444 and 447 of the Internal Revenue Code of 1939 as raised in your pro-

test and accompanying application for the benefits of Section 444 is disallowed since you have failed to establish eligibility under Subsection 444(b) of the Internal Revenue Code of 1939, and Regulations 130, Sections 40.444-1 and 40.444-2, and the amount of average base period net allowable under Section 444(c)."

As to this claim petitioner stated:

"This alternative claim is based upon Section 440(a) and (b)(3). Briefly, this section provides a special rule for computing the excess profits tax credit if a taxpayer can show that it has increased the unadjusted basis of its total facilities during the period of December 31, 1946, to December 31, 1949. The application of Section 444 to this case is confined to a single narrow question, whether leasehold improvements held by the taxpayer are facilities, within the meaning of the section. If they are, then the taxpayer admittedly is not entitled to the benefits of the special rule provided by Section 444, since it did not, according to the stipulated figures, increase its facilities including leasehold improvements by 200 percent."

In agreeing with this latter statement respondent Morris Plan Company of California says:

"As mentioned by Petitioner, the application of Section 444 to this case is confined to a single narrow question, namely, whether leasehold improvements held by Respondent at the specified periods are 'facilities' within the meaning of Section 444. Since the applicable portion of the definition of 'facilities' under Section 444(d) re-

quires that they be 'depreciable tangible property,' it is clear neither nondepreciable tangible property nor intangible property qualify as 'facilities.' If Respondent's leasehold improvements are not 'facilities,' then by stipulation it qualifies to determine its average base period net income under Section 444(c)."

Section 444(d) defines "facilities" as:

"For the purposes of this section, the term 'facilities' means real property and depreciable tangible property, held by the taxpayer in good faith for the purposes of the business."

Respondent argues that its leasehold improvements were not depreciable and also that the leashold improvements were not tangible. If respondent's leashold improvements are within the category of real property and depreciable tangible property, they are facilities under the definition.

In *H. D. & J. K. Crosswell v. Jones, Collector of Internal Revenue*, 4 Cir., 52 F.2d 880, it was held that:

Syll. 5. "Contracts acquired by partnership before incorporation, giving exclusive territorial right to bottle and sell Coca-Cola for which corporation issued its stock, held 'tangible property,' not being 'intangible property,' within income tax statute."

In its opinion the Court, beginning on page 881, said:

"It follows, therefore, that the sole question presented for determination by this court may be summed up as follows: 'Are the contracts acquired by the Plaintiff while a partnership and

turned over to the Plaintiff a Corporation at the date of organization for capital stock in the Corporation tangible property or intangible property.' Section 325. Revenue Act of 1918, defines the terms involved.

"'Sec. 325. (a) That as used in this title—

"'The term "intangible property" means patents, copyrights, secret processes and formulae, good will, trade-marks, trade-brands, franchises, and other like property;

"'The term "tangible property" means stocks, bonds, notes, and other evidences of indebtedness, bills and accounts receivable, leaseholds, and other property other than intangible property.'

"[1-3] It is very evident that, if we adopt a historical or scientific classification of property, these contracts must be held to be intangible. The difficulty arises by reason of the fact that the Revenue Act of 1918 repudiates the commonly accepted meanings of the words 'tangible' and 'intangible property,' and sets up a classification by its own terms. The act practically says that the distinctions between tangible and intangible property which have been recognized by legal history and the science of jurisprudence are not satisfactory for revenue purposes.* * *"

In the concluding portion of its opinion the Court stated:

"[6] Finally, there is the familiar rule that doubts in regard to a taxing statute should be resolved in favor of the taxpayer. The government by the act of 1918 set up new criteria by

which to distinguish between tangible and intangible property. For the purposes of this case we are confined to the meanings of these terms as set out in this section of the statute.

"In that we cannot find that the contracts involved are patents, copyrights, secret processes, formulae, good will, trade-marks, trade-brands, or franchises, nor that these contracts fall under the phrase 'other like property,' we are forced to the conclusion that for the purposes of taxation these contracts must be held to be tangible property."

Respondent's leasehold improvements fall within the general definition of tangible property appearing in 73 C.J.S. 155, § 5 of the article on Property.

Arguing that its leasehold improvements were not depreciable, respondent says:

"Respondent did not claim a deduction for depreciation for such allowance, but, as stipulated, correctly computed its deduction based solely on the remaining term of the applicable lease and not on the life of the assets."

It was stipulated that:

"Leasehold improvements were included in Petitioner's (respondent's) tax returns and separately identified as part of its 'Depreciation Schedule,' and allowance therefor was also separately identified under the legend, 'Reserve for Depreciation.' Such allowance was correctly established based solely on the remaining term of the applicable lease and not on the life of the asset."

We are in agreement with the result reached by the Tax Court on this issue and hold that the leasehold improvements were facilities under the meaning of § 444 and that the taxpayer is not entitled to any relief under §. 444 of the Internal Revenue Code of 1939.

With the exception of our discussion of the "alternative question," all of the above, unless otherwise indicated to the contrary, is to be considered as applying to both Valley Morris Plan and Morris Plan Company of California.

The decisions of the Tax Court in each of the cases are REVERSED.

(Endorsed) Opinion Filed May 22, 1962.

Frank H. Schmid, Clerk.

APPENDIX B.

Opinion of the Tax Court.

FINDINGS OF FACT AND OPINION

The Commissioner determined deficiencies in the petitioner's income and excess profits tax of $26,218.84 for 1950, $93,077.59 for 1951 and $147,416.99 for 1952. The primary issue for decision is whether Certificates issued by the petitioner and outstanding during the taxable years evidenced "borrowed capital" within the meaning of section 439 of the 1939 Code for the purpose of computing its excess profits credit based upon invested capital. An alternative issue, if the decision is against the petitioner on the above issue, is whether the petitioner is entitled to compute its average base period net income under section 444(c) of the 1939 Code in arriving at its "adjusted excess profits net income" because of a section 444(b)(3) increase in its capacity for production or operation.

Findings of Fact

The petitioner was organized in January 1916 and at all times material hereto was incorporated under and subject to sections 18,000 to 18,825 of the Financial Code of the State of California (entitled "industrial Loan Companies") and its predecessor, the Industrial Loan Act of 1917, as amended. Its principal office is at 715 Market Street, San Francisco, California, but it has other offices in California.

The petitioner used an accrual method of accounting and reporting its income. It filed its returns for the taxable years with the district director in San Francisco.

The petitioner is subject to regulation and examination by and must make an annual report to the Commissioner of Corporations of California. It was not a bank at any time material hereto. It is an industrial loan company. Its income for the taxable years was derived principally from discounts on notes and purchase contracts acquired by it and from interest on small loans made by it. It was authorized by its Articles of Incorporation "to issue, purchase and sell certificates, notes and other written evidences of indebtedness." It acquired its working capital from the sale of its capital stock and through loans from banks but primarily from the sale of its Certificates to the public.

The petitioner issued its Definite Term Thrift Certificates in face amounts of $500 and multiples thereof during 1950 and the first three months of 1951 but not thereafter.

The petitioner had outstanding but did not issue during the taxable years some of its Full Paid Investment Certificates and, up to April 1, 1951, some of its Unit Thrift Certificates. It had outstanding and issued during the taxable years its Installment Thrift Certificates. Each Certificate issued by the petitioner was registered by it by number and in the name of the owner. The definite term Thrift Certificates had a maturity date but the Installment Thrift Certificates bore no maturity date.

The laws of California required that the following be shown in large type on the face of each Certificate issued by the petitioner and other industrial loan companies: "This Is Not a Certificate of Deposit".

The petitioner was required under the California Industrial Loan Law to apply to the Division of Corporations of the state for permits and extensions thereof "authorizing the sale and issuance of securities", i.e., its Certificates. It had to make an application every time it wanted to issue new Certificates, to issue an additional amount of a type of outstanding Certificates or to change the interest rate on any type of outstanding Certificates. The application had to include a current financial statement, the resolution of the Directors pertaining to the issue, a copy of the proposed form of Certificate, a statement of the interest rate to be paid, the number of Certificates already issued on existing permits, the total amount of Certificates outstanding, the amount being requested and the period during which the Certificates would be issued. The application and the form of the Certificate had to be approved by the Division of Corporations before the Certificates could be issued.

The petitioner during the taxable years received numerous permits and extensions and amendments thereof to issue Certificates. Two permits were issued on December 21, 1950, authorizing total issues of $904,500 Definite Term Thrift Certificates paying 3 per cent per annum. An amendment to one of these permits was issued on June 26, 1951. All of the other permits, extensions and amendments pertained to the issuance of Installment Thrift Certificates. These were in amounts ranging from $100,000 to $20,000,000. Total issues of $600,000 at 4 per cent were permitted in 1950. A permit for $500,000 at 2½ per cent was issued in March 1950, one for $5,000,000 at 2 per cent in August 1950 and all of the others were at 3 per cent. If the in-

terest rate increased, holders of Certificates at a lower rate were notified and could change their investment to the higher rate.

The petitioner, upon receiving a permit, advertised to the public in the Wall Street Journal, the financial pages of other papers and through commercials on a music radio program, that it had Certificates for sale.

All advertising of the petitioner is subject to the approval of the Commissioner of Corporations of the State of California who checks the truth of all statements made to see that there are no ommissions or misleading statements and particularly that it does not lead the public to confuse the Certificates with bank deposits.

The interest on the Definite Term Thrift Certificates was paid when the Certificate was surrendered, whether at the 5-year maturity date or later and meanwhile drew interest at 3 per cent. The interest rate on the Unit Thrift Certificates ranged from 1½ per cent to 2½ per cent, depending upon the principal amount of each Certificate. The interest rate on Installment Thrift Certificates was 2 per cent or 2½ per cent during 1950 and the first three months of 1951 and thereafter was 3 per cent except that 4 per cent was paid on those issued to employees, of which $190,372.71 was the largest amount outstanding in any taxable year. The interest on the Unit and Installment Certificates was either paid or added to the principal semi-annually, as requested by the owner. The interest on the Full Paid Investment Certificates was paid semi-annually.

The prevailing interest rates paid on bank savings accounts in cities where the petitioner had offices did

not exceed 1 to 1½% per cent in 1950 and 2 per cent in 1951 and 1952.

The owner could add to his Unit Thrift Certificate $100 or multiples thereof. The owner could add to his Installment Thrift Certificate $1 or multiples thereof. All forms of Certificates issued by the petitioner were transferable and could be assigned as collateral. An assignment of a Definite Term ..... Certificate or a Full Paid Investment Certificate would continue in the assignee all benefits of the accumulating interest. The Certificates could be assigned at the office of the petitioner or by forwarding to the petitioner a properly endorsed certificate for assignment with the signature guaranteed, as in the case of the assignment of a stock certificate. The Certificates were not traded in markets or exchanges. Any Certificate could be redeemed in part or in full at any time since the petitioner did not invoke the restrictions on withdrawals.

The Installment ..... Certificates issued by the petitioner differ from bank savings accounts represented by a passbook at least in the following respects: The Certificates are transferable, they can be used as collateral, they are signed by the issuer, they are registered by the number that each bears and the name of the owner, the right of an owner to withdraw is limited with other withdrawals to the amount issued in the preceding month and they can be redeemed by the petitioner upon notice, whereas a bank savings account has none of these features, but a bank savings account is secured by cash reserves and by insurance, whereas the Certificates are not. Also, the bank receiving the deposits is examined by the banking authorities of the

state or nation, whereas the petitioner is subject to the supervision of the Division of Corporations of the state.

The average daily balance of the total amount of Certificates outstanding during each of the taxable years was: $16,073,897 for 1950, $17,866,997 for 1951 and $23,962,294 for 1952. The outstanding Installment Certificates averaged a little less than $13,000,000 during 1950, a little more than $16,000,000 during 1951 and a little more than $23,000,000 during 1952. The Unit Thrift Certificates averaged a little less than $3,000,000 during 1950 and were insignificant after April 30, 1951. The Installment Investment Certificates issued to employees were issued for the first time in April 1950 and thereafter averaged a little over $140,000 during 1950. They averaged a little over $150,000 during 1951 and a little over $176,000 during 1952. The Definite Term Thrift Certificates averaged a little over $266,000 during 1950, and a little over $474,000 for 1951 and a little over $342,000 for 1952. The Full Paid Investment Certificates did not exceed $1,500 at any time material hereto.

Similar averages for the borrowings from banks by the petitioner were $345,890.41 for 1950, $633,562 for 1951 and $461,252.51 for 1952.

The issuance by the petitioner of its Certificates was always in good faith for the purposes of its business.

The purchaser of an Installment Thrift Certificate is issued a book showing the Certificate number and having columns for the entry of withdrawals, payments, interest, balance and "Trans." The last page and inside cover of this book contain the following:

Installment Thrift Certficiate
of
The Morris Plan Company of California

The Morris Plan Company of California hereby certifies as follows:

1. ..... is the registered owner of this Installment Thrift Certificate of The Morris Plan Company of California, subject to the terms hereof.

2. The company is indebted to the registered owner hereof in the principal sum shown by the last balance entry herein when entered by an authorized officer or agent of the company, together with interest to be determined and computed as hereinafter provided.

3. The amount of this certificate may be increased in sums of One Dollar of multiples thereof, at any time by the registered owner hereof, subject to the following regulations.

4. Interest hereon at the rate of 3% per annum will be credited the registered owner hereof semi-annually on the first day of January and July of each year. Funds received between the first and third of each month will earn interest from the first day of that month; funds received after the third day of the month will receive interest from the first day of the following month, with the exception of January, April, July and October. Funds received before the tenth day of those months will receive interest from the first day of those months. Funds withdrawn will be deducted from the earliest credits. On withdrawals, no interest will be allowed thereon for the quarter in which withdrawn. A charge of 50c will be made for each withdrawal exceeding 2 in any one month.

5. The company will redeem this certificate in full, or any part of the same in sums of One Dollar or multiples thereof, at any time on request of the registered owner hereof, subject to the right of the company to require thirty (30) days' notice in writing, to limit the aggregate amount of the redemption of its Thrift Certificate in any one calendar month to an amount not exceeding its net receipts of the previous calendar month provided, however, that in the event the amount payable hereunder is not paid within six months from the date of demand, the entire amount due hereunder, together with accruals from date of demand shall become immediately due and payable.

6. Payment will be made to any person producing this certificate, who, on comparison of his or her signature with the signature of the registered owner on file with the company appears to be such owner or the duly authorized representative of such owner, and shall be a valid payment and discharge of the company from all liability for the amount so paid.

7. No money will be received or paid by the company hereon unless this certificate is presented, so that the proper entries of the same may be made hereon.

8. This certificate is registered in books kept at the office of the company and is transferable only upon its presentation of said company with a written assignment duly executed by the person appearing to be the registered owner hereof.

This certificate may be registered as payable to two or more persons, or their representatives, in which case payment to the person producing this certificate and appearing to be one or the other of such registered own-

ers, or the legal representative of either of such owners, shall have the same force and effect as if there were only one registered owner hereof.

9. In the event of the loss of this certificate and upon proof of such loss satisfactory to the company, a new certificate identical in form and conditions with this certificate will be issued to the person producing such proof, and who appears to be the registered owner hereof; and thereupon the company will be discharged from all further liability under this certificate.

10. The corporation reserves the right to redeem this Certificate at its face value with accrued interest, on any interest payment date, provided it shall give not less than thirty days' notice in writing addressed to the last recorded address of the registered owner or owners hereof, of its intention to redeem, and interest hereon shall cease on and after the date of redemption so indicated.

In Witness Whereof, The Morris Plan Company of California has caused this Certificate to be executed by its duly authorized officers this ..... day of ....., 19.....

Authorized Signature.

.....

This Is Not a Certificate of Deposit

The petitioner, in preparing its Federal income and excess profits tax returns for the years 1950, 1951 and 1952, considered and treated its indebtedness attributable to its Certificates issued and outstanding in each of the tax years as "borrowed capital" within the meaning of section 439(b)(1).

The Commissioner in determining the deficiencies gave the following explanation:

In your returns filed for the taxable years 1950, 1951, 1952 and 1953, you elected to compute your excess profits credit under the historical invested capital method provided by Section 458 of the Internal Revenue Code of 1939. In determining the average invested capital upon which you computed your excess profits credit, you included as borrowed capital 75 per cent of your obligations which were evidenced by Full Paid Investment Certificates, Certificates Receipt Book Form, and Installment Investment Certificates. It is held that your obligations evidenced by those certificates do not constitute borrowed capital within the meaning of Section 439 of the Internal Revenue Code of 1939.

Since your excess profits credit computed on your invested capital, exclusive of borrowed capital, is less than your excess profits credit as provided in Section 435 of the Internal Revenue Code of 1939, your excess profits credit is computed under Section 435.

Your alternative contention for allowance of average base period net income and excess profits credit under Sections 444 and 447 of the Internal Revenue Code of 1939 as raised in your protest and accompanying application for the benefits of Section 444 is disallowed since you have failed to establish eligibility under Subsection 444(b) of the Internal Revenue Code of 1939, and Regulations 130, Sections 40.444-1 and 40.444-2, and the amount of average base period net income allowable under Section 444(c).

All stipulated facts are incorporated herein by this reference.

Opinion

Murdock, Judge: The Term Thrift Certificates involved in the present case are not different in any material respect from those involved in the recent case of Valley Morris Plan, 33 T.C. .....(12-24-59), and for the reasons given there we hold that the petitioner is entitled to include the indebtedness evidenced by its Term Thrift Certificates in the computation of the invested capital credit.

The petitioner in the present case is claiming the right to include all of the indebtedness evidenced by its outstanding Certificates in the computation of its invested capital credit. These included not only the Term Thrift Certificates referred to above, but also an insignificant amount of Full Paid Investment Certificates which for present purposes can be regarded as similar to the Term Thrift Certificates, Unit Thrift Certificates which for present purposes are substantially similar to the Installment Thrift Certificates, Certificates issued to Employees which also may be regarded for present purposes as similar to the Installment Thrift Certificates and the Installment Thrift Certificates issued to the public which represent by far the largest amount in controversy.

Section 439(b)(1) provides, inter alia, that there shall be included in daily borrowed capital—

The amount of the outstanding indebtedness (not including interest) of the taxpayer, incurred in good faith for the purposes of the business, which is evidenced by a bond, note, bill of exchange, debenture, certificate of indebtedness, mortgage, deed of trust,

bank loan agreement, or conditional sales contract. * * *

It is stipulated that the petitioner's indebtedness on all of its Certificates was incurred in good faith for the purpose of its business.

The question for decision is whether the petitioner is entitled, in computing its excess profits credit under section 439(b)(1) to include the amount evidenced by its Installment Thrift Certificates in the computation of its borrowed capital. This point was not involved in the Valley Morris Plan case. The answer depends, under the arguments of the parties, on whether an Installment Thrift Certificate as issued by the petitioner might fairly be regarded as a "certificate of indebtedness" within the meaning of this section. The Commissioner has provided in Regulations 130, section 40.439-1(e) and (f) that—

* * * The name borne by the certificate is of little importance. More important attributes to be considered are whether or not there is a maturity date, the source of payment of any "interest" or "dividend" specified in the certificate (whether only out of earnings or out of capital and earnings), rights to enforce payment, and other rights as compared with those of general creditors.

The term "certificate of indebtedness" includes only instruments having the general character of investment securities issued by a corporation as distinguishable from instruments evidencing debts arising in ordinary transactions between individuals. * * * Borrowed capital does not include indebtedness incurred by a bank arising out of the receipt of a deposit and

evidenced, for example, by a certificate of deposit, a passbook, a cashier's check, or a certified check, and the term "bank loan agreement" does not include the indebtedness of a bank to a depositor.

The petitioner was not a bank and was prohibited by law from receiving deposits. Its certificates were not certificates of deposit. The portion of the above Regulation relating to banks has no application here. The interest specified in the Certificates was to be paid in any event and was not limited to payment out of earnings. The Certificates were not "instruments evidencing debts arising in ordinary transactions between individuals" but were distinguishable from such instruments in much the same way as are "instruments having the general character of investment securities issued by a corporation." These Certificates were issued by a corporation under express authority from the Department of Corporations. The application for the permit and the permit to issue these Certificates described them as "investments." They were also regarded as investments by the Securities and Exchange Commission. The petitioner obtained by far the largest part of its working capital from the sale of these Certificates. It seems fair to conclude from the entire record that they represented investments by the holders of the Certificates. They were similar in many respects to the types of evidences of indebtedness listed in section 439(b)(1). It is difficult to exclude these Certificates from borrowed capital under that section even under the Commissioner's regulations, despite their lack of a maturity date.

Commissioner v. Ames Trust & Savings Bank, 185 F. 2d 47, reversing 12 T.C. 770, National Bank of Commerce, 16 T.C. 769, and Capital National Bank of Sacramento, 16 T.C. 1202, appeal dismissed on stipulation, all involved regular banking institutions claiming borrowed capital on certificates of deposit and are not in point here where the petitioner is not a bank and is not making any claim based upon certificates of deposit which by law it is not even permitted to issue. A closely parallel case is Jackson Finance & Thrift Co., 29 T.C. 272. There are some differences in the facts between that case and this, but they do not serve to distinguish the two cases. That case was reversed, Jackson Finance & Thrift Co. v. Commissioner, 260 F. 2d 578.

The Court of Appeals for the Tenth Circuit in the Jackson Finance & Thrift Co. case pointed out that the State of Utah had adopted many statutory safeguards so that the issuance of thrift certificates by industrial loan companies could not be confused with banking functions. The same is true in the State of California. The Court said in part:

* * * Depositors place their money in banks primarily for safekeeping, secure in the knowledge that many governmental restrictions, both state and federal, are placed upon banks to assure and sometimes, as in the case of Federal Deposit Insurance banks, to insure the safety of the deposit. "Bank" and "bank deposit" are terms as well known in common parlance as they are in technical commercial use. And the terms do not include industrial loan companies nor monies received by sale of thrift certificates either in actual or

technical understanding. Money paid for thrift certificates (or other evidences of indebtedness whatever called) are intended as investments, influenced largely by the promise of payment of a high rate of interest, here 4%, but with a concomitant risk. Bank deposits are made at a lower rate of interest, here 2½%, for safekeeping.

The Court held that the certificates issued by the industrial loan companies in that case "are, and are intended to be, evidences of indebtedness to a purchaser who has invested, and has intended to invest, in a corporate security rather than make a deposit for safekeeping." Cf. Economy Savings & Loan Co., 5 T.C. 543, modified as to other issues, 158 F. 2d, 472, in which a similar conclusion was reached.

This Court, after restudying the whole question, has come to the conclusion that all of the indebtedness evidenced by the Certificates issued by the present petitioner should be included in the computation of the invested capital credit under section 439(b)(1). The parties have stipulated for each year the amount of equity capital as defined in section 437 under the above holding. The alternative issue raised by the petitioner need not be considered or decided in view of this holding.

Reviewed by the Court.

Decision will be entered under Rule 50.

[Endorsed]: Filed January 27, 1960.

APPENDIX C.

Opinion on Denial of Rehearing.

Before: HAMLIN and MERRILL, Circuit Judges, and FOLEY, District Judge

PER CURIAM:

The following statement appears in the court's opinion at page 28:

> We conclude from the foregoing that each of the institutions here is a bank as defined by § 104 of the Internal Revenue Code of 1939, as amended.

The respondents, petitioners herein, point out in their petitions for rehearing that section 104 defines "banks" as being institutions which are, *inter alia*, "subject by law to supervision and examination by State . . . or Federal authority having supervision over banking institutions." Since in California banks are "supervised" by the Superintendent of Banks and respondents are "supervised" by the California Corporations Commissioner, the petitioners claim that a vital element in the definition of banks under section 104 is missing and that consequently petitioners cannot be "banks".

While strictly speaking the above mentioned element in the definition of "banks" would not appear to be present in this case, we are, nevertheless, of the opinion that petitioners are "banks" within the intent and meaning of section 104. The federal tax laws are to be administered uniformly. The petitioners in substance have all the attributes of banks for purposes of the taxes here involved and therefore they should be treated accordingly. The authorities which have been

discussed establish that state law does not control what institutions are "banks" within the federal tax statutes. Just as in *Staunton* where the industrial loan association was organized under different state authority than were banks petitioners are organized in a manner different from banks and are controlled by different state authorities, albeit the state controls are stringent in either case. California's statutory choice based upon state criteria of exercising control by different authority over similar institutions cannot bring these petitioners without the confines of the definition of "banks" for federal tax purposes where the pertinent characteristics of the petitioner institutions are in substance the same as banks.

The opinion of the court is amended by the foregoing, and the petitions for rehearing are denied.

(Endorsed) Per Curiam Opinion on Rehearing Filed June 29, 1962.

Frank H. Schmid, Clerk.

APPENDIX D.

I.R.C. 1939, §§ 436, 437, 439, 444; § 719 (a) (1) Treas. Regs. 130, § 40.439-1 Treas. Regs. 112, § 35.719-1.

"'SEC. 436. EXCESS PROFITS CREDIT—BASED ON INVESTED CAPITAL.

"'(a) *General Rule.*—In the case of a domestic corporation (except a corporation described in subsection (b)) the excess profits credit for any taxable year computed under this section shall be the sum of the following:

"'(1) The invested capital credit computed under section 437, reduced by the amount computed under section 440(b) (relating to inadmissible assets), and

"'(2) The new capital credit, if any, computed under section 438(a).'"

"'SEC. 437. INVESTED CAPITAL CREDIT.

"'(a) *Definition.*—The invested capital credit for any taxable year shall be the amount shown in the following table:

"'If the invested capital for such year (as defined in subsection (b)(1)) is:	The credit shall be:
Not over $5,000,000	12% of the invested capital.
Over $5,000,000 but not over $10,000,000.'	$600,000, plus 10% of the excess over $5,000,000.
Over $10,000,000	$1,100,000, plus 8% of the excess over $10,000,000.

"'(b) *Invested Capital.*—

"'(1) *Election of Taxpayer.*—The invested capital for any taxable year shall be the adjusted invested capital determined under paragraph (2), except that if the taxpayer elects in its return for such taxable year to compute its invested capital

under the provisions of section 458, the invested capital for such year shall be the historical invested capital determined under section 458. For the invested capital of certain insurance companies, see paragraph (3).

"'(2) *Adjusted Invested Capital.*—The adjusted invested capital for any taxable year (hereinafter in this paragraph referred to as "the taxable year") shall be the sum of—

"'(A) the equity capital (as defined in subsection (c)) as of the beginning of the taxable year;

"'(B) the capital additional for the taxable year computed under subsection (d);

"'(C) 75 per centum of the average borrowed capital for the taxable year computed under section 439(a).'"

"'SEC. 439. BORROWED CAPITAL.

"'(a) *Average Borrowed Capital.*—For the purposes of this subchapter, the average borrowed capital for any taxable year shall be the aggregate of the daily borrowed capital for each day of such taxable year, divided by the number of days in such taxable year.

"'(b) *Daily Borrowed Capital.*—For the purposes of this subchapter, the daily borrowed capital for any day of any taxable year shall be determined as of the beginning of such day and shall be the sum of the following:

"'(1) The amount of the outstanding indebtedness (not including interest) of the taxpayer, incurred in good faith for the purposes of the busi-

ness, which is evidenced by a bond, note, bill of exchange, debenture, certificate of indebtedness, mortgage, deed of trust, bank loan agreement, or conditional sales contract. In the case of property of the taxpayer subject to a mortgage or other lien, the amount of indebtedness secured by such mortgage or lien shall be considered as an indebtedness of the taxpayer whether or not the taxpayer assumed or agreed to pay such indebtedness.'"

"'SEC. 444. AVERAGE BASE PERIOD NET INCOME—INCREASE IN CAPACITY FOR PRODUCTION OR OPERATION.

"'(a) *In General.*—If a taxpayer which commenced business on or before the first day of its base period establishes that, during the 36-month period ending on the last day of its base period, there was an increase, as defined in subsection (b), in its capacity for production or operation, the taxpayer's average base period net income determined under this section shall be the amount computed under subsection (c).

"'(b) *Increase in Capacity.*—An increase in capacity for production or operation shall be deemed to have occurred, for the purposes of this section, if the taxpayer establishes that it made an addition or additions to its facilities (as defined in subsection (d)) or replaced all or a part of its existing facilities, and that:

* * * *

"'(3) the basis (unadjusted) for determining gain upon sale or exchange of its total facilities on the last day of its base period was 200 per centum or more of the basis (unadjusted) for

determining gain upon sale or exchange of its total facilities on the day prior to the beginning of such 36-month period.

"'(c) *Average Base Period Net Income.*—The average base period net income determined under this section shall be computed as follows:

"'(1) By multiplying the amount of the taxpayer's total assets for the last day of its taxable year immediately preceding its first taxable year under this subchapter by the base period rate of return, proclaimed by the Secretary under section 447, for the taxpayer's industry.

"'(2) By subtracting from the amount ascertained under paragraph (1) an amount equal to the total interest paid or incurred by the taxpayer for the 12 months ending with the end of such immediately preceding taxable year.

"'(d) *Facilities.*—For the purposes of this section, the term "facilities" means real property and depreciable tangible property, held by the taxpayer in good faith for the purposes of the business.

"'(e) *Taxpayer's Industry Classification.*—For the purposes of this section, the taxpayer's industry classification shall be the industry classification under section 447 to which is attributable the largest amount of the taxpayer's gross receipts for its taxable year immediately preceding its first taxable year under this subchapter.'"

"'SEC. 719. BORROWED INVESTED CAPITAL.

"'(a) *Borrowed Capital.*—The borrowed capital for any day of any taxable year shall be determined as of

the beginning of such day and shall be the sum of the following:

"'(1) The amount of the outstanding indebtedness (not including interest, and not including indebtedness described in section 751(b), relating to certain exchanges) of the taxpayer which is evidenced by a bond, note, bill of exchange, debenture, certificate of indebtedness, mortgage, or deed of trust.'"

REGULATIONS 130, SEC. 40.439-1

"(f) The term 'certificate of indebtedness' includes only instruments having the general character of investment securities issued by a corporation as distinguishable from instruments evidencing debts arising in ordinary transactions between individuals. * * * Borrowed capital does not include indebtedness incurred by a bank arising out of the receipt of a deposit and evidenced, for example, by a certificate of deposit, a passbook, a cashier's check, or a certified check, and the term 'bank loan agreement' does not include the indebtedness of a bank to a depositor."

REGULATIONS 112, SEC. 35.719-1 (d)

"The term 'certificate of indebtedness' includes only instruments having the general character of investment securities issued by a corporation as distinguishable from instruments evidencing debts arising in ordinary transactions between individuals. Borrowed capital does not include indebtedness incurred by a bank arising out of the receipt of a deposit and evidenced, for example, by a certificate of deposit, a passbook, a cashier's check, or a certified check."

APPENDIX E.

Judgment of the Court Below.

[Title of Court of Appeals and Cause.]

JUDGMENT

Upon Petition to Review a Decision of The Tax Court of the United States, this Cause came on to be heard on the Transcript of the Record from The Tax Court of the United States, and was duly submitted.

On Consideration Whereof, it is now here ordered and adjudged by this Court, that the Decision of the said Tax Court of the United States in this Cause be, and hereby is reversed.

Filed and entered May 22, 1962.

APPENDIX F.

Opinion of the Court of Appeals for the 10th Circuit in Jackson Finance & Thrift Co.

Before BRATTON, Chief Judge, and PHILLIPS and LEWIS, Circuit Judges.

LEWIS, Circuit Judge.

These appeals from a decision of the Tax Court were consolidated, as were the proceedings below, because of the existence of a controlling law question. No. 5893 involves tax deficiencies imposed upon Jackson Finance and Thrift Co. for the fiscal years ended April 30, 1951, 1952 and 1953; the companion case imposes similar deficiencies upon Ford Finance Co. for the calendar years 1951, 1952 and 1953.

The controversies arose under the Excess Profits Tax of 1950 and the determinative question, answered in the negative by the court below, is whether or not monies received by the taxpayers through the issuance of "thrift certificates" constitute borrowed capital for the purposes of excess profits credit. Section 436 of the Internal Revenue Code of 1939 (26 U.S.C.A. Excess Profits Taxes, § 436) allows an excess profit credit based on invested capital, and for the purposes of this credit Section 437 (26 U.S.C.A. Excess Profits Taxes § 437) provides that invested capital shall include a certain percentage of borrowed capital. Section 439(b) (1) of the Act and Code, as we will later more particularly note, defines borrowed capital.

Each of the taxpayers is an industrial loan corporation organized and operating under the statutory authority of the State of Utah. 7-8-1 et seq. Utah Code Ann. 1953; 7-6-1 et seq., Utah Code Ann. 1943,

as amended. The companies are primarily engaged in the making of interest bearing loans to individuals, repayable in uniform installment payments and within the rate, time and security limitations set by the applicable Utah statutes, supra. The Utah Code, now 7-8-3, Utah Code Ann.1953, also empowers industrial loan corporations to "issue and sell certificates for the payment of money at any time, either fixed or uncertain, and to receive payments therefor in installments or otherwise, with or without allowance of interest on such installments; provided, that nothing herein shall be construed to authorize such corporations to receive deposits or to create any liability due on demand. The certificates issued by any such corporation shall be approved as to form by the bank commissioner, and shall bear upon the face of the instrument the words, 'This is not a certificate of deposit.'" In compliance with this statutory authorization each company issued what they termed "thrift certificates" in the following form:

> "This Is To Certify that ..... of ..... has delivered to Jackson Finance & Thrift Co. (Ford Finance Company), a corporation, the sums of money as listed hereafter and in consideration of the same, the said corporation agrees to repay the said sums to the said party or order as herein provided with interest payable at the rate of ..... per centum from date until paid. Amounts of less than $100.00 shall not draw interest under this Contract.
>
> "This Thrift Book may be issued as payable to one or more persons in which case payment to the persons producing this Thrift Book and ap-

pearing to be either one or the other of such owners, shall have the same force and effect as if there were only one owner.

"The said corporation reserves the right to retain this Thrift Book at its face value with accrued interest on any date, by giving notice in writing, by registered mail, to the last known address of the owner or owners hereof as furnished to the said corporation by the owner hereof, of its intention to redeem the same, and interest shall cease on and after ten (10) days from the mailing of such notice.

"The said corporation will redeem this Thrift Book at any time on the request of an owner hereof at its face value and accrued interest, subject to the right of the Corporation to require thirty days notice in writing, and to limit the aggregate amount of withdrawal payments of its thrift books in any one calendar month to an amount not exceeding one-half its net receipts of the previous calendar month.

"This Is Not A Certificate Of Deposit.

"In Witness Whereof the said corporation has caused this Thrift Book to be signed by its duly authorized officer and its seal to be affixed hereto this ..... day of ....., 19.....

"Jackson Finance & Thrift Co.

"(Ford Finance Company)

"By ..... Withdrawals may be made from this account on the signature, or signatures, appearing below.

.....

....."

A single thrift certificate book was used to evidence a continuing relationship between taxpayers and their customers, notations being entered in the books to indicate monies received by the companies or withdrawn by the customers. The books were surrendered upon complete withdrawal of individual accounts and, in actual practice, the companies required no notice from their customers of intent to withdraw from the accounts. Interest at the rate of 4%[1] was paid upon the accounts.

During the years pertinent to present inquiry the Ford Finance Company had a daily average of outstanding indebtedness attributable to the issuance of thrift certificates of an amount, again averaged for the three-year period, of over $800,000; the Jackson company, of over $90,000. It is these amounts that the Tax Court determined not to be borrowed capital within the meaning of Sec. 439(b)(1), supra, which defines such capital as including—

> "* * * the outstanding indebtedness (not including interest) of the taxpayer, incurred in good faith for the purposes of the business, which is evidenced by a bond, note, bill of exchange, debenture, certificate of indebtedness, mortgage, deed of trust, bank loan agreement, or conditional sales contract."

In aid of the statutory definition of borrowed capital under the Excess Profits Tax of 1950 the Treasury Department promulgated its regulation Sec. 40.439-1(f), (Treas. Reg. 130, Int. Rev. Code, 1939), which defined certificates of indebtedness thus:

> "(f) The term 'certificate of indebtedness' includes only instruments having the general charac-

[1] Commercial savings bank in the same community were then paying 2½% upon deposits.

ter of investment securities issued by a corporation as distinguishable from instruments evidencing debts arising in ordinary transactions between individuals. The term 'conditional sales contract' means a contract corresponding to a mortgage except that the transfer of title is made dependent upon the payment of the stipulated price. Borrowed capital does not include indebtedness incurred by a bank arising out of the receipt of a deposit and evidenced, for example, by a certificate of deposit, a passbook, a cashier's check, or a certified check, and the term 'bank loan agreement' does not include the indebtedness of a bank to a depositor."

In 1945, the Tax Court had occasion to consider the identical question which now reaches us through this appeal. In such year the same statutory definition of borrowed capital was in effect under the World War II Excess Profits Tax Act (Public Law No. 801, 76th Cong. 3d Sess., Oct. 8, 1940, 54 Stat. 975)[2] and the departmental regulations defined certificate of indebtedness in the same terms[2] as the later regulation set out above. In Economy Savings and Loan Co., 5 T.C. 543, modified on appeal on other issues, 6 Cir., 158 F.2d 472, the Tax Court concluded that monies received by the taxpayer through that company's issuance of "certificates of deposit" were an indebtedness evidenced by a certificate of indebtedness and that as a consequence the taxpayer was entitled to a tax credit for borrowed capital. The Commissioner did not question this ruling on appeal and in fact issued his formal acquiescence to the ruling of the case.

[2]Treas.Reg. 112, Sec. 35.719-1, Int.Rev. Code, 1939.

Both the decision of the Tax Court in the instant case and the position of the Commissioner on present appeal recognize a direct reversal of the earlier position taken by each in Economy and rely upon the authority of Commissioner of Internal Revenue v. Ames Trust & Savings Bank, 8 Cir., 185 F.2d 47, as dictating the necessity therefor. We can see no such compulsion in the rationale of Ames and most certainly not in its express words for it is there stated at page 50:

> "We should perhaps add that we do not consider Economy Savings & Loan Co. v. Commissioner, 5 T.C. 543, affirmed on other grounds, 6 Cir., 158 F.2d 472, cited by the Tax Court and relied upon by the bank here, as being in any way applicable to the present situation. Under the contract governing the dealings of the parties, the funds received by the loan company in that case were not of the nature of a deposit transaction with a bank, as the court itself there recognized, in saying that 'Respondent's suggestion that petitioner was really in the banking business and that the funds evidenced by the certificates herein involved are analogous to the deposits of a bank is not borne out by the evidence.' "

Just as the distinction between deposit liability of banks and the commercial indebtedness of loan companies was recognized in Economy it was further held determinative in Ames.

[1, 2] At the time that Congress enacted the Excess Profits Tax Act of 1950 it failed to amend, revise or in any way alter the definition of borrowed

capital as it was contained in the earlier World War II Act except to add transactions evidenced by conditional sales contracts and bank loan agreements. At such time the judicial interpretation of the Tax Court in Economy, the administrative interpretation of the Treasury Department through regulation, and the formal acquiescence of the Commissioner in the holding of Economy were all part and parcel of the actual and effective administration of the earlier tax statute. The distinction between the deposit liability of a bank and the nature of a borrowing transaction such as we here consider had, in 1950, been recognized both judicially and administratively. By re-enacting the statutory definition of borrowed capital for purposes identical with that definition's original purpose it must be presumed that Congress both approved and intended to adopt the judicial and administrative interpretation and construction that had been placed upon its words by those responsible for statutory interpretation and administration. Such rule is a fundamental principle of statutory interpretation[3] and is dispositive of the instant case unless successful contention can be made that a factual situation here exists which would put taxpayers within the rule applicable to banks. And such is the Commissioner's principal claim in argument before this Court although the Tax Court re-

[3]United States v. Ryan, 284 U.S. 167, 52 S.Ct. 65, 76 L.Ed. 224; Hecht v. Malley, 265 U.S. 144, 44 S.Ct. 462, 68 L.Ed. 949; Commissioner of Internal Revenue v. E. G. Bonfils Trust, 10 Cir., 115 F.2d 788; Bakelite Corporation v. National Aniline & Chemical Corp., 2 Cir., 83 F.2d 176; Carroll Electric Co. v. Snelling, 1 Cir., 62 F.2d 413; Sanger v. Lukens, 9 Cir., 26 F.2d 855; Barnhill v. Commissioner, 5 Cir., 241 F.2d 496; cf. Commissioner of Internal Revenue v. Glenshaw Glass Co., 348 U.S. 426, 75 S.Ct. 473, 99 L.Ed. 483; Diamond v. Sturr, 2 Cir., 221 F.2d 264.

fused to pass on the merits of such contention.[4] Since the burden is upon taxpayers to prove that the deficiencies imposed upon them are wrong under any proper theory it is our duty to consider all contentions of the Commissioner that might sustain the contrary view. Cf. Helvering v. Gowran, 302 U.S. 238, 58 S.Ct. 154, 82 L.Ed. 224.

Sec. 438(g) of the 1939 Code relates the term "bank" as contained in Sec. 104 of that Code, 26 U.S.C.A. (I.R.C. 1939) § 104, to the excess profits tax and so defines bank thus:

> "* * * a bank or trust company incorporated and doing business under the laws * * * of any State * * * , a substantial part of the business of which consists of receiving deposits and making loans and discounts, * * * and which is subject by law to supervision and examination by State, Territorial or Federal authority having supervision over banking institutions."

Under the law of Utah,[5] industrial loan companies are subject to regulation through the supervision of the State Bank Commissioner and to this extent fall clearly within the definition of a bank as defined above. And it would be unrealistic not to note the marked similarity in business procedure between the intake of funds by a bank through savings deposits and that of the taxpayers through the issuance of the thrift certificates. But it would be equally unrealistic not to

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[4]Opper, J. dissenting, stated: "It seems to me impossible to dispose of this case on the authority of respondent's regulation without concluding that petitioner was a 'bank.'"

[5]Now 7-8-1 et seq., Utah Code Ann.1953.

note that such similarity is limited to form and does not exist either in law or fact. Depositors place their money in banks primarily for safekeeping, secure in the knowledge that many governmental restrictions, both state and federal, are placed upon banks to assure and sometimes, as in the case of Federal Deposit Insurance banks, to insure the safety of the deposit. "Bank" and "bank deposit" are terms as well known in common parlance as they are in technical commercial use. And the terms do not include industrial loan companies nor monies received by sale of thrift certificates either in actual or technical understanding. Money paid for thrift certificates (or other evidences of indebtedness whatever called) are intended as investments, influenced largely by the promise of payment of a high rate of interest, here 4%, but with a concomitant risk. Bank deposits are made at a lower rate of interest, here 2½%, for safekeeping.

[3.] To preserve both the legal and actual concept of the term "bank" and "bank deposit" Utah has adopted many statutory safeguards so that the issuance of thrift certificates cannot be confused with banking functions. The certificates must state on their face: "This is not a certificate of deposit." Industrial loan companies are prohibited from using the word 'bank' or 'bank deposit' in their business. Now 7-3-57, Utah Code Ann. 1953. And they cannot accept deposits.[6] Industrial loan companies can-

[6]As part of the record in this case the Commissioner stipulated that the taxpayers "had never engaged in any of the primary banking functions of discount, *deposit* or circulation." Although counsel had difficulty during oral presentation in justifying his argument that taxpayers were banks in view of this stipulation we have preferred to place no emphasis upon the stipulation.

not become members of the federal reserve system and are not eligible for deposit insurance with any federal agency. It seems clear that taxpayers are not banks, are not performing banking functions, and are not receiving bank deposits through the issuance of their thrift certificates. Such certificates are, and are intended to be, evidences of indebtedness to a purchaser who has invested, and has intended to invest, in a corporate security rather than make a deposit for safekeeping. The judgments of the Tax Court are accordingly severally

Reversed.

APPENDIX G.

Opinion of the Court of Appeals for the 6th Circuit in United States v. City Loan & Savings Company.

Before MILLER, CECIL and WEICK, Circuit Judges.

WEICK, Circuit Judge.

This case involves the question whether indebtedness evidenced by certificates of deposit issued by the taxpayer is to be considered and treated as borrowed capital for excess profits tax credit purposes under the provisions of Section 439(b) (1) of the Excess Profits Tax Act of 1950. 26 U.S.C. 1952 Ed., Sec. 439.

The taxpayer is a building and loan corporation organized under the laws of Ohio. It is engaged in the personal loan and finance business and is licensed under the Small Loan Act of Ohio, R.C. § 1321.01 et seq. Its operations are under the supervision of the Superintendent of Building and Loan Associations and of the Division of Securities of the State of Ohio. It is permitted by law to accept deposits for which it issues either certificates of deposit or pass books. It also maintained special employees' savings accounts. These deposits were not subject to withdrawal by check or draft, but could be withdrawn only in accordance with the provisions of the bylaws of the company.[1]

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[1] "Depositors whose deposits are not pledged, or who are not otherwise indebted to this Company, may as a general rule, upon written application, withdraw all or any part of their deposits at any time, providing the money is in the depository. The application shall be filed as received and paid in that order as fast as fifty per cent of the regular receipts of the company will pay them; but the Board of Directors in its discretion may use all

During the taxable period, taxpayer paid interest on its deposits as follows: 3% per annum on straight certificates; 3½% on certificates, if money was left for one year or more, and 2½% on pass book accounts. On employees' special savings accounts, it paid 3% up to 8%. The banks in the area where it raised all its capital paid only 1% per annum interest on savings accounts and certificates of deposit. Taxpayer is not a member of the Federal Reserve System or of the Federal Deposit Insurance Corporation. It has never been designated a depository of state or federal funds. It is not permitted under Ohio law to include the word "bank" in its name or to engage in the primary banking functions of discount, deposit and circulation.

In preparing its tax return for the year 1951,[2] taxpayer computed its excess profits tax liability under the provisions of Section 439(b) (1) of the Excess Profits Tax Act of 1950 and treated its certificates of deposit including pass books and employee savings accounts as borrowed capital within the meaning of that section.

This treatment was based on the practice followed by the Commissiner of Internal Revenue in auditing taxpayer's returns for excess profits tax years during World War II and on the decision of the Tax Court in Economy Savings & Loan Co. v. Commissioner,

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receipts of the company to pay withdrawals. The liability of the Company to pay interest shall cease with the application. All withdrawals shall be taken from the oldest deposit and no withdrawals from any one account or certificate shall exceed $500 in each thirty days ahead of other pending applications, but the Board of Directors may in its discretion pay withdrawals not exceeding $25 at one time, not exceeding $100 within thirty days regardless of the order of the applications filed."

[2]"1952 is also invol ed to the extent of a carry-back from that year to 1951 to an unused excess profits credit."

1945, 5 T.C. 543 modified on other issues by this Court in 158 F.2d 472. This decision of the Tax Court upheld such treatment with respect to certificates of deposit of a similar corporation organized under Ohio law and was acquiesced in by the Commissioner. (1945 Cum.Bull. #3.)

The taxpayer had filed a claim for refund on issues other than here involved and during consideration thereof by the Appellate Division of the Internal Revenue Service in Cleveland, it was determined that no refund was due for 1951, but that there was a deficiency for that year in the amount of $443,421.36 plus interest on the ground that taxpayer's certificates of deposit did not represent borrowed capital within the meaning of said Section 439 of the Act. This affected taxpayer's liability not only for 1951 but also for the tax years of 1952 and 1953 in the approximate amount of $2,750,000.00. Taxpayer paid the deficiency for 1951 and filed claim for refund which was disallowed and the present action in the District Court followed.

The facts were stipulated.[3] The District Judge tried the case without a jury. He held that the Commissioner of Internal Revenue either lacked power to deny or was equitably estopped from denying that the taxpayer's certificates of deposit represented borrowed capital within the meaning of the law and that in any event the certificates of deposit did constitute borrowed capital. He rendered an oral opinion and adopted findings of fact and conclusions of law and entered judgment in

[3] Under the stipulation we consider only the certificates of deposit used by taxpayer for raising operating capital and not pass books or employees' savings accounts which were not in issue.

favor of the taxpayer and against the Government for $799,543.95 plus interest. This appeal followed.

The Excess Profits Tax Act of 1950 provides:

> "(b) Daily Borrowed Capital.—For the purposes of this subchapter, the daily borrowed capital for any day of any taxable year shall be determined as of the beginning of such day and shall be the sum of the following:
>
> "(1) The amount of the outstanding indebtedness (not including interest) of the taxpayer, incurred in good faith for the purposes of the business, which is evidenced by a bond, note, bill of exchange, debenture, certificate of indebtedness, mortgage, deed of trust, bank loan agreement, or conditional sales contract. * * *"

(See: U.S.C.1952 Ed., Sec. 439.)

There is no material difference between this statute and the Excess Profits Tax Act which was in effect during World War II. 26 U.S.C. § 719(a) (1). We will treat them as identical for the purposes of this case.

The Treasury regulations promulgated under this statute are contained in footnote[4]

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[4]Treasury Regulations 130, Promulgated under the Internal Revenue Code of 1939:

"Sec. 40.439-1 Borrowed Capital. * *

* * * * * * * * * *

"(e) Whether outstanding certificates designated by such names as 'debenture preferred stock' or 'guaranteed preferred stock' constitute borrowed capital depends upon whether the holder has a proprietary interest in the corporation or has the rights of a creditor, determined in the light of all the facts. The name borne by the certificate is of little importance. More important attributes to be considered are whether or not there is a maturity date, the source of payment of any 'interest' or 'dividend' specified in the certificate (whether only out of earnings or out of

It was not disputed that the certificates of deposit issued by taxpayer constituted an outstanding indebtedness owing by it to the holders of the certificates and that such indebtedness was incurred in good faith for the purposes of its business. The only remaining requirement of the statute is that the debt be evidenced by any one of the nine instruments therein specified. A sample certificate of deposit issued by taxpayer is shown in footnote.[5]

Is this certificate of deposit a certificate of indebtedness and does it constitute borrowed capital within the meaning of the statute?

In Economy (5 T.C. 543) the Tax Court held that it was a certificate of indebtedness and constituted borrowed capital. In that case the taxpayer was an Ohio building and loan company engaged in the personal loan and finance business and issuing pass books and certificates of deposit substantially identical with those of the taxpayer.

In Jackson Finance & Thrift Co. v. Commissioner, 10 Cir., 1958, 260 F.2d 578,[6] the Court held that

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capital and earnings), rights to enforce payment, and other rights as compared with those of general creditors.

"(f) The term 'Certificate of indebtedness' includes only instruments having the general character of investment securities issued by a corporation as distinguishable from instruments evidencing debts arising in ordinary transactions between indivduals. The term 'conditional sales contract' means a contract corresponding to a mortgage except that the transfer of title is made dependent upon the payment of the stipulated price. Borrowed capital does not include indebtedness incurred by a bank arising out of the receipt of a deposit and evidenced, for example, by a certificate of deposit, a passbook, a cashier's check, or a certified check, and the term "bank loan agreement" does not include the indebtedness of bank to a depositor."

[5][Specimen Omitted]

[6]This decision reversed the decision of the Tax Court reported in 29 T.C. 272. The Tax Court applying the rule in Ames, supra,

"Thrift Certificates" issued by an industrial loan company organized under Utah law constituted borrowed capital for excess profits tax credit purposes under § 439(b) (1) of the 1939 Code. The Government distinguishes this case from Economy on the ground that Jackson could not accept deposits under Utah law whereas Economy could under Ohio law.

Following the decision in Jackson the Tax Court held that thrift certificates for a fixed term issued by an industrial loan corporation under California law evidenced borrowed capital for excess profits credit purposes. Valley Morris Plan Co. v. Commissioner, 1959, 33 T.C. 572. Later it applied the same rule to Thrift certificates payable in instalments. Morris Plan Co. v. Commissioner, 33 T.C. 720 (1960). In California, like Utah, industrial loan companies are not permitted to accept deposits. Economy was cited in both cases.

As before indicated, the Government relies on Commissioner of Internal Revenue v. Ames Trust & Savings Co., 8 Cir., 1950, 185 F.2d 47 which held that certificates of deposit issued by a bank payable within 6 or 9 months with interest were not certificates of indebtedness within the meaning of the Excess Profits Tax Act. The Court distinguished Economy on the ground that the certificates in Economy were not of the nature of a deposit transaction with a bank and that

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had held that the thrift certificates did not constitute borrowed capital for excess profits tax credit purposes." The Tax Court said that the holding in Economy 'that a certificate of deposit is a certificate of indebtedness and constitutes borrowed capital for excess profits tax purposes will no longer be followed.' This statement, however, was not repeated in later decision of the Tax Court which cited Economy. Valley Morris Plan Co. v. Commissioner, 1959, 33 T.C. 572; Morris Plan Co. v. Commissioner, 1960, 33 T.C. 720.

Economy was not a bank as was Ames Trust & Savings Bank. This would seem to us to be a valid distinction rendering Ames inapplicable to the present case.

After Ames, the Tax Court recognized the distinction between commercial indebtedness and deposit liability of a bank and held that the latter was not to be included in borrowed capital under the Excess Profits Tax Act of 1950. National Bank of Commerce, 1951, 16 T.C. 769 (deposits evidenced by certificates of deposit and pass books); Southern Bank of Norfolk, T.C.Memo.Op. Dkt. 29543 (Jan. 22, 1952); Cf. Capital National Bank of Sacramento, 16 T.C. 1202; LaSalle National Bank, 23 T.C. 479.

In National Bank of Commerce, supra, the Tax Court referred to the legislative history of the 1950 Act. In the Senate Finance Committee, Senate Report 2679, 81st Cong., 2d Session, December 18, 1950, it is stated:

> "The category of indebtedness evidenced by a bank loan agreement, added by your committee's bill, includes such indebtedness owing to a bank and does not include the indebtedness of a bank to its depositors."

The Government contends that although taxpayer is not a bank it exercises some functions similar to those of a bank in accepting deposits, issuing pass books and certificates of deposit and in making personal loans. The deposits of taxpayer were not similar to those of a bank in that withdrawal was subject to provisions of its bylaws. Bank deposits on the other hand are treated as cash and may be withdrawn on demand unless they provide for a fixed term. Taxpayer was not a bank, but a building and loan company. A bank would not be

classified as a building and loan company simply because it made loans on real estate.

The Treasury Regulations quoted in footnote 4 expressly exclude indebtedness incurred by a bank, arising out of the receipt of a deposit and evidenced by a certificate of deposit, from treatment as borrowed capital. They would not seem to apply to a building and loan company, which is not a bank, even though it may exercise a few functions similar to those exercised by a bank.

While the question in this case is a close one, we think that the administrative practice of the Commissioner in following Economy for so many years is not to be lightly discarded. In our judgment, the findings of the District Judge are not clearly erroneous. We would not be justified in disturbing them. Commissioner of Internal Revenue v. Duberstein, 1959, 363 U.S. 278, 80 S.Ct. 1190, 4 L.Ed.2d 1218; Graver Tank & Mfg. Co. v. Linde Air Products Co., 339 U.S. 605, 70 S.Ct. 854, 94 L.Ed. 1097.

The judgment of the District Court is affirmed.